INDEMNIFICATION OF GOVERNMENT CONTRACTORS

HEARINGS
BEFORE THE
SUBCOMMITTEE ON AGENCY ADMINISTRATION
OF THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
NINETY-SEVENTH CONGRESS
SECOND SESSION
ON
INDEMNIFICATION OF GOVERNMENT CONTRACTORS

SEPTEMBER 30 AND DECEMBER 2, 1982

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INDEMNIFICATION OF GOVERNMENT CONTRACTORS

THURSDAY, SEPTEMBER 30, 1982

U.S. SENATE,
SUBCOMMITTEE ON AGENCY ADMINISTRATION,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:17 a.m., in room 2228, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the subcommittee) presiding.

Staff present: John Maxwell, chief counsel and staff director; Lynda Nersesian, counsel; and Susan Shirk, chief clerk.

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. This hearing marks the first of two oversight hearings that this subcommittee will conduct on the Federal Government's tort liability in the context of an indemnity or contribution action.

I am aware of industry's interest in forming a record on this topic. Industry representatives have conveyed their dissatisfaction with an ordering of liability that has become increasingly onerous to the Federal Government supplier. To the consternation of many in the Government contracting field, the potential exposure to liability for Government contractors is quite broad, while their right of indemnification or contribution from the Government is considerably restricted.

The most compelling set of facts illustrating the supplier's predicament in military procurement arises from a 1977 Supreme Court decision involving Stencel Aero Corp. Under the circumstances of that case, Stencel obtained an Air Force contract to build an ejection seat, including the parachute, for the F-100 and F-102 fighters. During testing of the parachute, built to Air Force specifications, Stencel discovered the riser wires that connect the parachutist to his canopy could cut the chute. Stencel told the Air Force about the problem and suggested a design change. The Air Force, however, did not agree and ordered a simpler, cheaper change to solve the problem.

After the ejection seats were put into use, Capt. James Werner of the California Air National Guard died after he was forced to eject from his F-102 near Fresno. An Air Force investigation concluded his death was directly attributable to the defective design of his parachute pack. Stencel settled a $189,000 suit with Werner's heirs after the Air Force refused to accept any liability.

Two years later, another National Guard pilot, Capt. John Donham of the Missouri Air National Guard, was permanently disabled when he ejected from his F-100. This second separate lawsuit went to the Supreme Court. Stencel argued that the Air Force should share some liability. In 1977, the Court ruled that the Federal Government could not be sued in such cases.

The Air Force then made a design change in the parachute which was almost identical to that originally proposed by Stencel. The Court determined that the Feres doctrine barred any claim under the Federal Tort Claims Act. This subcommittee held hearings on this doctrine on April 14 of this year, but did not touch on the doctrine's role in product liability litigation.

I emphasize the facts of the *Stencel* case because the decision in that case, along with the ramifications of the widely accepted strict liability theory, are in large part why we are here today in this hearing.

We have with us today a very distinguished panel of witnesses. In addition to the Department of Justice, we will be hearing from representatives of Eaton Corp., the National Association of Manufacturers' Task Force on Government Indemnification, Electronic Industries Association, and Crowell & Moring.

Our first witness is Mr. J. Paul McGrath, Assistant Attorney General, Civil Division, Department of Justice.

Paul, you have contributed a great deal to prior hearings on amendments that we have to the Federal Tort Claims Act; specifically S. 1775. I am happy that you are here today to offer further contribution to this very important hearing.

Mr. McGrath. Thank you, Mr. Chairman.

Senator Grassley. I hope I am not going to be called to the floor to vote. What I would like to do is make a statement of procedure before you start, Paul. It would be my hope that we could keep the testimony of witnesses to 10 minutes, because I do have questions that I would like to ask each, so I want some participation in this hearing as well.

So, we would include the entire statement in the record in every instance, unless somebody would ask that they not have a statement included, and I ask you to summarize if the reading of the statement cannot be done in 10 minutes. I only say that because I want to follow that procedure. Sometimes I find myself cutting off people at the tail end unfairly and I do not want to do that. So, I want to be alert this time to starting out on the right track.

So, would you proceed, Paul?

STATEMENT OF J. PAUL McGRATH, ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. McGrath. Thank you very much, Mr. Chairman. I very much appreciate the opportunity to appear here this morning on behalf of the Justice Department at this hearing where you are considering these very important matters.

I do request that my prepared statement be incorporated into the record of this hearing, and I would simply like to point out some of the considerations that seem to us most important in the matters before the subcommittee today.

As is indicated in my testimony, the administration strongly opposes suggestions that the Government's obligations to provide contribution or indemnity to Government contractors be broadened.

The current law represents a balancing of many interests. To be sure, we have gotten far away from earlier notions of sovereign immunity, under which basically the sovereign could do no wrong and could not be sued in either contract or tort. But the current state of the law recognizes correctly, I believe, that the Government is different from other parties in litigation.

The Government is not a profitmaking organization. The only money that the Government has to spend is taxpayers' money, and as we are all too aware, that is available in limited quantities. And many competing interests look to that money for various social, economic, and other programs. Thus, there is clearly a need to consider very carefully any program that would extend, and particularly extend a great deal, the obligations of the Federal Government.

On the other hand, the current state of the law recognizes that the Government should undertake liabilities in many situations. The Government is now generally liable in tort where Government employees have, through their negligence or wrongful conduct, caused injury to others. The Government is liable in contract, again, under rules which have become relatively established.

We believe that the current balance makes sense and that, in general, the proposals to extend Government liability to Government contractors would not only be inappropriate and would undermine, at least to some extent, the appropriations process but, in addition, would give Government contractors an unfair advantage over all the other people who are impacted by conduct of the Federal Government.

Two particular situations have been raised by proponents of change in this area. One is the concern that you referred to, Mr. Chairman, in your opening remarks and that is illustrated by the *Stencel* case. We discuss that in my testimony, but, in general, the concern is that the obligations of the Federal Government to its employees is limited; that that limitation of liability carries over to a situation where a third party is found liable to an employee who is subjected to damages and then cannot sue over and against the United States for contribution or indemnity.

As we indicate in my testimony, we believe the *Stencel* case was correctly decided and should not be overruled by legislation. The main reasons for that are, first, that there are schemes which have been worked out with respect to governmental employees—the Veterans Benefit Act, the Federal Employees Compensation Act, and other schemes. Those schemes have been designed to provide for a fair balance in terms of compensating Government employees, and to let third parties come in and sue to recover from the Government in those situations would simply undermine those schemes.

In addition, of course, where the suits involve military personnel, the whole concept behind the Feres doctrine comes into issue, and we believe it is very important to strictly adhere to that doctrine, lest the operation of the military, and particularly military personnel relations, be undermined.

The other situation that has been raised a good deal is the so-called catastrophic loss situation. The proposal is that the Government's liability in catastrophic loss situations should be broadened by broadening the indemnity which the Government would give to Government contractors.

We believe that the current state of the law, as implemented by executive orders, makes sense. In general, such indemnities are permitted sparingly and where necessary, where there are ultrahazardous activities involved in military procurement programs and where there are certain research and development programs involved in military situations.

We, of course, are willing to consider and have considered other situations where slight extensions of these indemnities might be appropriate under a good showing that such extensions were necessary. But, in general, we do not favor extensions of indemnity or contribution with respect to the Federal Government.

Mr. Chairman, that summarizes what I think are the most important points in our testimony, and I would be very happy to answer any questions that the subcommittee may wish to put.

Senator **Grassley**. I suppose you might think the first question is an effort on my part to trap you. But in order that the Government be fairly consistent in its testimony, I think we should note that in the writing of S. 1775—an amendment to the Federal Tort Claims Act that has the effect of immunizing Government employees against acting within the scope of their employment—one of our objectives was to provide the plaintiff with a deep-pocket defendant.

Would you agree that the victims of a Government-sponsored activity should similarly not have their remedy dependent on the size or solvency of a contractor?

Mr. **McGrath**. I think there is a big distinction between the two situations, Mr. Chairman. What we have been talking about in connection with S. 1775 is that where an individual has been subjected to a constitutional tort that has damaged that individual, if there is to be a remedy, as the Supreme Court held in the *Bivens* case, we believe that remedy is meaningless under the current law because, by and large, the defendants not only do not have a deep pocket, but they typically do not have anything in their pocket at all beyond perhaps court costs.

If there is to be any meaningful recovery there, the only entity that can possibly provide it is the Federal Government. On the other hand, where we are talking about Government contractors, by and large—there may be exceptions—but by and large, contractors are financially profitmaking institutions, business institutions, or perhaps large universities or other such institutions, which do have the wherewithal to provide compensation where someone is injured.

In addition, where there is no Government contractor, where someone simply has been injured through the conduct of Government employment—in that situation, the Tort Claims Act provides for a deep-pocket recovery against the United States, with the exception of those situations that are written into the act as exceptions, such as the discretionary function exemption.

So, in general, I would say the two situations that we are talking about are somewhat different in that respect.

Senator **Grassley**. Well, then, are there any changes in the present state of the law governing indemnification of Government contractors which the Justice Department could support?

Mr. **McGrath**. At this point, Mr. Chairman, they would be changes in the opposite direction from what the proponents of the legislation we are discussing have suggested. There have been some cases which have possibly provided some breach in the defense of the independent contractor defense in the Federal Tort Claims Act. If those cases are not favorably dealt with on appeal or in the Supreme Court, we may very well seek legislation which would strengthen the independent contractor exemption.

With that possible exception, at this point we do not see any change in the law in this area that we would support.

Senator **Grassley**. Is that a long-standing position of the Justice Department or is it a recent one, or is it just simply posturing?

Mr. **McGrath**. No, it is certainly not posturing. I do not personally have a long institutional memory on this, but to the best of my knowledge, it has been the position. I cannot say the Justice Department has never taken a different position, but my understanding of that has generally been the position of the Department of Justice.

Senator **Grassley**. Does the Justice Department know of any draft legislation prepared by any Government agency regarding the problem of contractor indemnification, and if you know of any, could you tell us how it reads?

Mr. **McGrath**. I do not personally, Mr. Chairman. None has come to my attention. I cannot say there is not any because things get drafted all around the Government, but I personally am not aware of them.

Senator **Grassley**. I am not yet finished with my questioning, but I might want some of the people who are going to testify to be thinking of that last question I just asked as well.

Does the Justice Department maintain any records indicating the amount of use and the cost of such use that has been made of existing indemnification statutes, such as Public Law 85–804, the Price-Anderson Act, the swine flu immunization program, and the space vehicle user indemnification provisions?

Are any records like that kept, and if so, could you provide such information? If not, can the information be compiled and provided?

Mr. **McGrath**. Mr. Chairman, of those statutes, I believe that the only one where we really have any records that would provide this information is the swine flu immunization program. The reason for that is that, generally, the Department of Justice Civil Division administers that program, approves settlements, whether they are administrative or otherwise, and handles the litigation.

So, we do have a record of the number of settlements, the number of claims, the number of adverse judgments, and so on, and could provide that. Otherwise, these programs are generally not administered by the Department of Justice and the costs or the number of situations, for instance, in which Public Law 85–804 has been applied is not something I believe we have either a compilation of information on, or raw data from which you could get that information. That is what I am informed.

As far as litigation is concerned, our current computer system does not break things down this way, so we could not pull it out of our computer in areas other than swine flu.

Senator GRASSLEY. Well, is your position that it just cannot be put together?

Mr. McGRATH. It could not be put together, other than in the swine flu area, from information that we have at the Justice Department, yes, sir.

Senator GRASSLEY. Does the Justice Department have a record of the private relief legislation which has been acted over a period, let us say, of 30 years, in order to enable Government contractors to obtain indemnification for costs of liability to third parties?

Mr. McGRATH. Mr. Chairman, I do not know the answer to that question. Could I check on that and supply an answer for the record?

Senator GRASSLEY. Yes, and, of course, we hope that that information is available because I think private relief bills are the alternative to the enactment of legislation. I deal with those in this subcommittee, and I would not say that the work is overwhelming. But I think that it is a very cumbersome process for the citizen and one that has too much politics involved as opposed to the neutrality that we ought to have.

Mr. McGRATH. Yes. As you know, we have generally been very concerned about private relief exemptions, particularly in areas such as this. I will see what information we do have on this and supply it to the subcommittee.

Senator GRASSLEY. That is the last question that we have for the present, but we will want to submit some more questions to you in writing, because we want to pursue this.

Mr. McGRATH. Fine.

Senator GRASSLEY. You have been very helpful, and even though you do not support at this point any change in the law, at least we have found that we have been able to work with you, and we hope you will continue to be available.

Mr. McGRATH. Well, we certainly will, Mr. Chairman. As you know, we enjoy working with your subcommittee and look forward to cooperating in whatever way we can.

Senator GRASSLEY. Thank you very much.

Mr. McGRATH. Thank you, Mr. Chairman.

[The prepared statement and submissions of Mr. McGrath follow:]

PREPARED STATEMENT OF J. PAUL McGRATH

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I am pleased to appear before your Subcommittee in response to your letter of August 20, 1982 to the Attorney General, which invited the Department of Justice to present testimony on the practicability of providing a scheme of contribution or indemnification of Government contractors in appropriate circumstances.

The Department of Justice opposes current proposals to enact legislation requiring that contractors' expenses be paid out of public funds. These proposals ignore the special nature of government--a non-profit generating institution--and would undermine the appropriations process. They would result in a significant drain on the public treasury without any of the usual restraints on payments, which is reason enough to resist the proposals in light of the insubstantial showing of need to revise the present system. Also, there is no justification for proposals which give contractors special rights or remedies which are not generally available to others or which detract from the play of market forces and hinder efforts to keep the costs of government programs and procurements to a reasonable minimum. To summarize, contribution or indemnification remedies are presently available within reasonable limits. The present system of tort accountability strikes a balance for the affected parties that operates in the public interest; accordingly, the Department cannot support the thesis that additional legislation is necessary or appropriate.

Examination of the law as it now stands is a necessary beginning point for analyzing the proposed expansion of remedies against the United States.

Where indemnity is available, one tortfeasor may recover payments made by it to an injured person if a third person is jointly liable in tort for the same harm and if the prime responsibility for payment should fall on the third person. Restatement, Torts 2d, §§886B. Contribution is generally available when two or more persons become liable in tort to the same person for the same harm, each is at fault and no right to indemnity is recognized. Restatement, Torts 2d, §§886A.

The Federal Tort Claims Act provides jurisdiction, subject to the limitations and conditions set forth in the Act, for suits brought by government contractors, or others, seeking contribution or indemnity. United States v. Yellow Cab Company, 340 U.S. 543 (1951). Contribution and indemnity claims may be pursued through third party practice in pending federal litigation when permitted by the Federal Rules of Civil Procedure without the necessity of filing a claim for money damages with the affected agency first. 28 U.S.C. §2675(a). Thus, government contractors have the same right to sue for contribution or indemnity as do other persons seeking tort damages from the United States.

Similarly, the Tucker Act is a comprehensive scheme whereby the United States may be sued on breach of contract claims. 28 U.S.C. §1491 et seq. The usual rule of contractual indemnity is that each party to the contract is presumed to be liable to the extent that its negligence caused damage. This rule is applicable to government contractors. See United States v. Seckinger, 397 U.S. 203 (1970). The authority of agencies to enter into contracts may not, however, be used to expand the indemnification clauses in federal contracts and, thus, to undermine the appropriations process. Accordingly, an indemnity agreement which purports to authorize indemnification by the United States on a basis broader than that grounded upon the proportionate negligence of federal employees or officials is void under 31 U.S.C. §665(a) and 41 U.S.C. §11. See Comptroller General Opinion B-201394, April 23, 1981 (In The Matter of Indemnification of Agents and Brokers Under the National Flood Insurance Act). I will focus, therefore, upon general principles of tort liability and their application to government contractors' claims for indemnification and contribution from the United States.

The history of the Federal Tort Claims Act and its provisions is instructive. In the 1880's, Congress first enacted the Tucker Act, which permits suits against the United States for breach of contract. At that time, it was proposed to permit suits sounding in tort to be maintained against the United States; the proposal died because of opposition in the Congress. See, Jayson, Handling Federal Tort Claims, §54. In the 1920's and 30's there was desultory consideration of bills to create a general tort remedy enforceable in court against the United States. Although there was general agreement that the United States should be subjected to some tort liability, there was considerable debate on how that liability should be limited, given the unique character of the federal government. See, generally, Id., Chapter 2.

The Federal Tort Claims Act, enacted in 1946, culminated the legislative consideration. One point is evident: "Uppermost in the collective mind of Congress were the ordinary common-law torts. Of these, the example which is reiterated in the course of the repeated proposals for submitting the United States to tort liability is 'negligence' in the operation of vehicles." Dalehite v. United States, 346 U.S. 15, 28 (1953). The structure of the FTCA, including its subsequent amendments, furthers this general purpose.

In keeping with this purpose, liability under the FTCA has exceptions. For instance, it does not extend to render the United States liable for the acts or omissions of a contractor. 28 U.S.C. §2671. In recognition of the uniquely governmental nature of certain activities and decisions, matters which are discretionary functions may not form a basis of liability. 28 U.S.C. 2680(a). Jurisdiction may be exercised only for injury or loss of property or personal injury or death caused by "the negligent or wrongful act or omission" of federal employees. Thus, "liability does not arise by virtue either of United States ownership of an inherently dangerous commodity or property, or by engaging in an 'extrahazardous activity'." *Dalehite* v. *United States*, 346 U.S. 15, 45 (1953). In other words, a finding of fault is the touchstone of FTCA jurisdiction; "[r]egardless of state law characterization, the Federal Tort Claims Act itself precludes the imposition of liability if there has been no negligence or other form of misfeasance or nonfeasance . . . on the part of the Government." *Laird* v. *Nelms*, 406 U.S. 797, 799 (1972). Again this excludes liability based on the ultrahazardous nature of an activity undertaken by the Government. *Id*. at page 801.

The limitations on tort suits against the United States make eminent sense. Congress has moved cautiously to ensure that the Government will not be visited "with novel and unprecedented liabilities as a result of expanded tort liability," *Feres* v. v. *United States*, 340 U.S. 135, 142 (1950), because expanded relief would result in an enormous additional cost to the federal taxpayer.

Proposals to expand the liability of the United States to government contractors seem to follow two approaches: (1) they would overturn limitations on the right to seek indemnification or contribution from the federal government; and (2) they would permit the United States to be held liable in tort without proof that federal employees were at fault. See, *e.g.*, H.R. 1504, 97th Cong., 1st Sess., a bill "To provide Government indemnity for suppliers of products to the Government in certain cases in which suppliers become liable for loss with respect to those products, and for other purposes." As I will discuss, the principles at stake are fundamental barriers against redistribution of economic risk. If the proposals are adopted, potentially enormous drains on the public fisc could well ensue, and important public policies would be disserved. I will address the two thrusts of these proposals in turn.

The Department of Justice opposes expansion of indemnity or contribution remedies. Proposals to extend contractors' rights to permit recoveries over against the United States when it cannot be sued directly expand indemnity beyond the contours which give meaning to this term of art. Basic to indemnity and contribution is the concept that "defendant must be a tortfeasor, and originally liable to the plaintiff." Prosser, Law of Torts, §50, p. 309. The FTCA follows this legal rule. If the United States were held liable to indemnify contractors when it was not liable to a person to whom the contractors were liable, tort indemnity would be stretched beyond recognition.

Affirmative policy reasons dictate retention of the present limitations on indemnification. The lawsuit entitled Stencel Aero Engineering Corp. v. United States, 431 U.S. 666 (1977) is a good illustration of the policies underpinning the limitations on contractors' indemnity rights. In Stencel, an ejection system manufactured by Stencel malfunctioned in an emergency causing injury to a member of the Armed Forces. The injured person obtained a lifetime pension pursuant to the Veterans Benefits Act, 38 U.S.C. §321 et seq. and sued the United States and Stencel claiming damages of $2,500,000. Stencel cross-claimed against the United States for indemnity, claiming that faulty specifications or requirements resulted in the malfunction at issue. The United States moved to dismiss both the Armed Forces member's claim and Stencel's claim. The government relied on the well-recognized rule that the United States is not liable for injuries sustained incident to military service and argued that this rule precluded both the direct suit and the cross-claim. See Feres v. United States, 340 U.S. 135 (1950). After the district court granted both motions, Stencel appealed. The Supreme Court ultimately affirmed dismissal for several cogent reasons.

The Supreme Court's decision in Stencel dwelt on the distinctively federal character of the relationship between the Government and its suppliers, a relationship no less distinctly federal than the relationship between the Government and its soldiers. (Id. at p. 672).

The Supreme Court was also concerned in Stencel that permitting a suit for contribution or indemnity would undermine the compensation scheme reflected in the Veterans Benefit Act, because that Act not only provides a swift, efficient remedy for the injured serviceman but it also "clothes the Government in the 'protective mantle' of the Act's limitation of liability provisions." (Id. at p. 673). Thus, the Supreme Court considered the military compensation scheme to provide "an upper limit of liability for the Government as to service connected injuries." (Ibid).

The Supreme Court considered a third factor, the extent to which litigation would bring into the courtroom the second guessing of military orders in the course of the determination of fault, if any, a factor which underlaid its original formulation of the Feres doctrine. It was clear to the Supreme Court that second guessing of military decisions by courts would have a real potential for undermining military discipline and weakening the effective operation of military forces. This kind of concern likewise was perceived as weighing "against permitting any recovery . . . ." (Ibid).

While the Supreme Court's decision in Stencel was grounded upon its construction of the Federal Tort Claims Act, the rationale which led to rejection of Stencel's indemnity claim likewise cautions against revision of the Act to overturn the result in that case. Because of the large, although uncertain, liability to which the United States would be exposed and the potential impact upon the military services, the Department opposes any dilution of the Stencel Aero decision or reversal of the principles upon which it is based.

Moreover, the Department of Justice disagrees with any suggestion that the United States should be liable for third party claims arising from the tort suits filed by its employees. Most state workmen's compensation statutes have been construed to deny contribution when a third party is sued by an employee, because the employer cannot be said to be jointly liable in tort to the employee. Larson, Workmen's Compensation Law, §76. Similarly, defenses available against the employee are available against a plaintiff in a third party suit seeking contribution or indemnity, even if suit is otherwise permitted. Larson, Workmen's Compensation Law, §75. Thus, the Stencel Aero decision extends to the United States the same limitation of liability which most employers have by virtue of state workmen's compensation laws. The Federal Employees Compensation Act similarly enacted a comprehensive exclusive liability remedy for work-related injuries to most federal employees. I urge that the existing system be preserved, especially in view of the compelling reasons, grounded in the uniquely governmental functions served thereby, for not permitting government contractors to have preferential rights to seek contribution and indemnity. See Certain Underwriters at Lloyd's v. United States, 511 F.2d 159, 169 (5th Cir. 1975).

The second thrust of the proposals--to permit the United States to be sued without any finding of fault on the part of its employees--is equally objectionable. In order to avoid unprecedented liability against the United States, Congress generally has taken care to provide that the United States is liable only when one of its employees was at fault. One of the few exceptions to that rule is reflected in the Swine Flu Act of 1976, P.L. 94-380, 94th Cong., 2nd Sess. As I have discussed, the United States, by nature of its unique governmental role, necessarily engages in extrahazardous activities. Application of strict liability principles and other forms of vicarious liability or liability without fault are precluded under the FTCA; thus the public is not liable for uniquely governmental activities.

This result is central to the scheme of the FTCA. As a consequence, the public fisc is protected under circumstances where it most needs protection, i.e., where proof of fault on the part of federal employees is not found. This enables the cost to the federal government of paying tort claims to be kept within reasonable bounds.

It has also been argued that the government should indemnify suppliers since it--the government--specifies the items purchased.

> The Government deals with its suppliers in a monopsonistic manner. It dictates the terms and conditions of its contracts. It supervises and controls the inspection, testing and acceptance of the supplies and services which it procures. It determines and controls the manner, type and circumstances of use and the nature and extent of maintenance. It establishes and is responsible for the safety rules and procedures governing its activities and it determines and controls the nature and extent of the training of using personnel. In short, its control of all the circumstances where there is multiparty negligence at all, governmental negligence would most probably be supervening whereas that of the supplier would in most cases be passive and secondary.

[Letter of Theodore Kostos, Chairman, American Bar Association, Section of Public Contract Law, March 22, 1980, to the Honorable George Danielson, Chairman, Subcommittee on Administrative Law and Government Relations, 96th Cong., 2nd Sess., reprinted in Government Contractors Product Liability Act hearings, Subcommittee on Administrative Law and Governmental Relations, Judiciary Committee, House of Representatives, 96th Cong., 2nd Sess., serial number 56, p. 53.] This argument assumes that the government actually has the "in-house" capacity to design and control the manufacture of sophisticated products or services. In practice, the process works quite differently. Sophisticated American technology is generated by the creativity and hard work of modern corporate enterprises--not by unilateral government action. More to the point, this is precisely how it should work.

The government should utilize the creative genius of the enterprises with which it does business to the fullest extent possible. These enterprises now have a strong economic incentive to reduce tort liability since they are not assured that the liability can be passed to the United States. A rule of indemnification which gave a supplier unlimited indemnification rights would reduce greatly the economic incentive to design and produce the best and safest possible products and would turn the competitive, profit-oriented benefits of our economic system on their head. Instead of providing incentives to produce as good and safe a product as possible, expanded indemnification of contractors would deter effective utilization of the profit motive, which is at the heart of an otherwise effective procurement system. Congress should not enact legislation that would provide a disincentive for safety on the part of contractors nor should Congress look favorably on legislative proposals which would cause the taxpayers to pay for expertise which rightfully should be procured outside the government. These are the effects of proposals to expand contractors' indemnification rights. If enacted, legislation of this sort would result in the taxpayers' assumption of enormous potential liability.

Congress has enacted special legislation authorizing indemnification of contractors in carefully defined and limited situations. See 10 U.S.C. §2354 (military research and development), 50 U.S.C. §1431-1435 (P.L. 85-804) and 41 U.S.C. §2210 (the Price-Anderson Act)). These provisions go as far as the Congress need go to deal with those exceptional instances in which the competitive process would not otherwise enable vital items or services to be procured.

Proposals to expand indemnification have been urged for two decades. See Dembling, Catastrophic Accidents Indemnification of Contractors Against Third Party Liability, 10 Journal of Space Law 1 (Sp. 1982). The rationales for these proposals are frequently rested on an asserted fear that contractors will not do business with the government or that insurance costs will increase to prohibitive levels if indemnification is not promised. These fears have proven to be greatly exaggerated. Government contracts still are sought after. The fact that considerable visible effort goes into the competitive battle to secure an edge in receiving this business speaks eloquently against the argument that the expansion of indemnification is necessary.

There are additional reasons why the present state of the law should not be modified in order to give preferred treatment to certain government contractors. Any additional indemnification remedy for parties with whom the government has no direct contractual or other relationship is undesirable because it would give a windfall to insurers and others who are liable directly, all at the expense of the taxpayers. Moreover, because agency policy usually precludes referral of product liability claims against contractors to the Justice Department for consideration of affirmative suits on product liability theories, government contractors at present are in the relatively enviable position of not being visited by product liability suits brought by their customers when the customers are federal agencies.

Finally, as Assistant Attorney General for the Department of Justice's Civil Division, I must express concern that, in addition to the potentially enormous cost of indemnification, there would be a concomitant administrative cost--federal agencies and the Department of Justice would be required to assign personnel and other resources to the function of obtaining factual information, investigating and defending the new kinds of claims and litigation which proposals to expand government contractors' indemnity and contribution rights would necessarily entail.

For all of these reasons, the Department of Justice opposes legislation which would change the reasonable, well-settled rules pertaining to government contractors' indemnity and contribution rights against the United States. We are certainly aware that there are other perspectives in this area. We will continue to discuss and examine the issue of indemnification to those who do business with the government.

Mr. Chairman, I would be pleased to respond to your questions.

U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

NOV 01 1982

Honorable Charles E. Grassley
Chairman
Subcommittee on Agency Administration
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed is the corrected transcript of the testimony of J. Paul McGrath, Assistant Attorney General, Civil Division, in connection with oversight hearings conducted by the Subcommittee on Agency Administration on September 30, 1982, concerning product liability problems encountered by government contractors. Also enclosed are further responses to questions at the hearing.

At the hearing, Mr. McGrath stated he would provide statistics on litigation and claims arising under the Swine Flu Program of 1976. Those statistics are enclosed. It should be noted that the statistics for swine flu claims are to some extent duplicative of the statistics covering lawsuits.

Mr. McGrath also agreed at the hearing to look into whether the Department of Justice has records of private relief legislation which has been acted upon over the past thirty years concerning indemnification of government contractors for costs of liability to third parties. Unfortunately, the files of the Department do not extend over the entire period and, in any event, are not organized in such a manner as to make retrieval of this information feasible.

I trust that the foregoing response is sufficient to answer the questions raised at the hearing.

Sincerely,

Robert A. McConnell

Robert A. McConnell
Assistant Attorney General

Enclosures

TORTS BRANCH
CIVIL DIVISION
DEPT. OF JUSTICE

SWINE FLU STATISTICS

As of: 10-7-82

SUITS	NO.	AMOUNT REQ'D	AMOUNT REC'D
Filed	1,578	2,119,960,111	
Dismissed	414	469,195,170	
Settled	295	298,206,679	28,702,635
Judgments (liability stipulated)	41	81,774,803	15,852,405
Judgments for Plaintiff	22	42,493,084	6,681,437
Judgments for Defendant	132	184,379,865	0
Pending	674	1,043,910,510	
CLAIMS			
Filed	4,121	3,020,957,767	
Denied	2,792	1,945,047,626	
Closed	160	43,617,514	
Settled	273	121,203,187	6,559,519
"Deemed Denied"	516	558,137,581	
Deemed Denied/Settled	332	308,562,524	28,702,635
Pending	47	44,275,542	
TOTAL SETTLED:	605	429,765,711	35,262,154
TOTAL AWARDED:			57,795,996

Comments: Some suits include multiple claims.

Senator GRASSLEY. Our next witness is Mr. Richard Brown. He is the vice president in the law department of the electronics and defense sector of TRW Inc. TRW is a diversified, multinational company providing high-technology products and services to the transportation, electronics, aerospace, industrial, and energy markets.

In his representation of the National Association of Manufacturers—and I hope I am right on that—Mr. Brown represents approximately 12,000 manufacturing companies, 80 percent of which are small businesses.

I welcome you here, Mr. Brown, and I will note for the record that Ms. Laramie McNamara of TRW has been particularly helpful in providing materials to this subcommittee. I would like to have you proceed in the same manner that I previously have designated, and I want to thank the previous witness for keeping within the time constraints that I had suggested.

STATEMENT OF T. RICHARD BROWN, VICE PRESIDENT, ELECTRONICS AND DEFENSE SECTOR, TRW INC., REPRESENTING THE NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. BROWN. Good morning, Mr. Chairman. I will make every effort—I guess I feel I have a little more substance to say than the last witness, which may make it difficult to stay within the time constraints.

Senator GRASSLEY. Fine. We are aware of the important contribution that your testimony does make, and it is fairly unique testimony. I appreciate that and I think we can probably, because we are on time, accommodate that. Proceed.

Mr. BROWN. In connection with my position as a lawyer at TRW, I am frequently called upon to give legal advice on our various contracts involving products and services which, in the event of some accident, could clearly cause serious personal injury or property damage—items such as spacecraft, missiles, lasers, and sophisticated computer systems, just as examples.

I have become increasingly concerned with the resulting liability implications since, in my view, present law places a disproportionate, unjust burden on the contractor to absorb this liability. Therefore, I was quite pleased to accept the chairmanship of an industry task force formed by the National Association of Manufacturers to assess this problem and recommend remedial action.

A written statement has been submitted for the record, but I do appreciate the opportunity to summarize the principal points and to answer any questions that you may have.

This subject raises some very fundamental issues with respect to Government sovereign immunity, the responsibility of the Government for wrongful acts or omissions of its employees, and the fairness to be applied in transactions with private-sector contractors who respond to the exceptionally diverse requirements of the Government's contracting agencies.

In the interest of brevity, I will refer simply to contractors, but I do want to make it clear that the problem being addressed also refers to subcontractors and other suppliers, as well as prime contractors who deal directly with the Government. Indeed, the great majority of business entities satisfying the Government's needs are small subcontractors and suppliers that are frequently unable to maintain large amounts of insurance, and would hence be the most adversely affected by liability claims.

It is very important, in my opinion, that America's broad industrial base not be deterred from pursuing Government contract business opportunities by arbitrary and inequitable factors.

As indicated, one evolving obstacle to a company considering a Government program is the potential for incurrence of third party liability; that is, the prospect of monetary claims asserted by persons who are harmed in unforeseen occurrences, unforeseen by both the Government and the contractor, which lead to loss of life, bodily injury, or property damage.

While liability may only accrue under a very small percentage of Government contracts, the threat and unknown impact of a liability incident, if one should occur, is a growing constraint upon competition for Government business. Contractors cannot ignore the litigation explosion of recent years, nor the trend toward inflationary recoveries in the courts, nor the creative theories developed to justify tapping the deep pockets of private enterprise in the understandable desire to compensate innocent victims.

How do we now handle liability flowing from a contract initiated and administered by the Government? To what extent is there a procedure for some reasonable allocation of liability costs as between the Government and contractors?

Now, my formal statement sets forth four hypothetical cases, Mr. Chairman, that I think illustrate the kinds of problems that could be created in this arena, and I will not bother here, in the interest of time, to reiterate those situations. But I think they do point out both the situation where the contractor is not at all at fault, where some Government fault in the way of defective specifications or faulty maintenance of a product or service after it has been delivered can lead to liability directly to Government employees, and the contractor is unable to secure indemnity from the Government; or, in addition, the situation where you can have a massive catastrophic loss beyond any reasonable levels of insurance and the contractor, again, is essentially left responsible for that excess liability.

While the recent history of Government procurement has been remarkably free of such disastrous incidents, again, no contractor can rationally assume that every kind of unpredictable mishap can be prevented. It is therefore prudent to assess those potential consequences and the alternatives before making a decision to pursue a particular contract.

What options are open to contractors to avoid or ameliorate these liability dangers? Well, obviously, the availability, the affordability and the cost effectiveness of liability and casualty insurance need to be evaluated. Suffice here simply to say that few knowledgeable sources, if any, regard insurance as the panacea.

The government is best able to develop a reasonable allocation of liability, and we think it is perfectly appropriate for agencies to determine a reasonable level of liability insurance or self-insurance to be maintained. However, it does not make sense either from the contractor's standpoint or the Government's standpoint to encourage contractors to carry excessive levels of insurance to cover the worst-case possibilities under every contract. Over the long term, the Government's financial interests are best served by assuming the responsibility for losses in excess of reasonable levels of insurance.

How about the contractor simply increasing its prices and passing this along to the Government? The Supreme Court, in *Stencel*, appeared to imply that *Stencel*, in the case that you have described, Mr. Chairman, should have recognized its risk in that particular fact situation and priced its product accordingly.

This is simply impractical in light of the abundant Government regulations and practices designed to elicit from contractors the lowest possible price without any speculative additions in the way of contingent liability. Moreover, since contractors often do business exclusively with the Government and frequently deliver limited quantities of products or services, they do not have the equivalent ability of commercial producers to spread their costs across a broad marketplace.

Incidentally, it should also be noted that there is no parallel in private commerce to the diversity of needs and the risk potential which Government acquisition activity presents. It is hardly appropriate to say that these extraordinary liability consequences are a normal cost of doing business.

How about contract bargaining? Agencies have always been very reluctant to negotiate liability indemnification or contribution provisions into their contracts, if for no other reason than the lack of clear authority to offer such protection to their contractors.

The Comptroller General has injected further confusion on this score by holding that standard clauses frequently used by both military departments and civilian agencies in certain of their cost reimbursement contracts are violative of the Anti-Deficiency Act and Adequacy of Appropriations Act, because they purport to obligate government funds to payment of contingent liabilities which are uncertain at the time the contract is entered into.

What about ad hoc statutory relief from Congress? From time to time, Congress has approved such measures, again, as you summarized in your introductory statement, Mr. Chairman, ostensibly because Congress was aware or was advised that it was essential to pass these measures in order to convince contractors to proceed in the face of manifest liability risks.

I think logic compels the question, why are these unique beneficiaries any more entitled to protection than the mass of contractors whose good-faith labors are instrumental to a functioning Government? If, indeed, the congressional intent is to absolve contractors from unreasonable liability in these high-risk situations, then this should be done uniformly without leaving contractors uncertain as to whether Congress has been or will be foresighted enough or sympathetic enough to approve some special relief bill.

In surveying these divergent indemnity statutes, the Commission on Government Procurement concluded in 1972 that new legislation was necessary to codify a national policy that contractors could and should be shielded from catastrophic liability beyond levels of reasonable insurance. Regrettably, despite many reiterations of the justification for this legislation by contractors, agencies and the Office of Federal Procurement Policy, no truly substantive action has been taken to date.

Consequently, we are here today in an effort to persuade this subcommittee that remedial legislation is warranted and desirable in order to resolve the dilemma which contractors face by having to assume risks of Government negligence and unreasonable liability as a quid pro quo for competing for Federal contracts.

My written statement includes a draft statute that we consider to be a workable and evenhanded solution to the problems presented. This proposed act would grant a contractor a right of contribution from the Government proportionate to the fault of the Government in creating the liability. This comparative fault approach to liability allocation between joint defendants has been widely accepted and applied in both Federal and State courts.

Second, catastrophic liability would be treated by having contracting agencies fix, through regulation, the amount of third-party liability which it deems reasonable for its contractors to bear through insurance or self-insurance. In an appropriate situation, that might be $1 million, it might be $10 million, it might be $500 million. That would be for the agencies to establish, but contractors would know their position on the front end. Indemnity would then be provided for any excess, unreasonable liability unless it was incurred due to some fraud, misconduct or gross negligence on the part of the contractor.

Legislation of this nature will benefit the Government procurement process and otherwise serve the public interest in the following respects.

Contractors will be better able to appraise the contingent liability risk associated with their performance, and this will thereby increase the prospects that they will bid on essential, albeit risky, Government programs. More philosophically, but not to be underestimated, a sense that the Government plays fair will be engendered.

Contracting agencies will obtain the advantages of increased competition. Moreover, this would clarify their authority on such matters and free them up to concentrate on performance aspects of specific products and services being sought, rather than engaging in diversionary rebuttals of the legitimacy of contractor liability worries.

INJURED PARTIES

By having in place an orderly framework for satisfying the liabilities that arise out of Government programs, there is an enhanced likelihood that victims will be compensated promptly and reduced chances that no recovery will be attained due to contractor insolvency brought on by claims of catastrophic proportions.

Congress will benefit from the time and effort saved in the implementation of continuing, countless private relief bills for individualized situations, whether they be contractor hardship cases, massive claims flowing from catastrophies, or critical projects where no contractor will proceed in the absence of liability safeguards.

Before concluding, I would like to comment just briefly on the position of the Justice Department. I think it can be readily summed up: The status quo is fine; contractors ought to stop pestering Congress and the contracting agencies and get on with their business.

Perhaps this posture should not be surprising, but it is disappointing that there is such a lack of understanding of the negative consequences to the procurement process and the public interest in the present state of the law.

I think that flaws in the Justice Department reasoning are manifest. Mr. McGrath seems to grant that it is appropriate for the Government to bear liability when its negligent employees are responsible, but he completely reverses his field if the liability is generated by claims of Government employees against a contractor.

He expresses fear that contractors will be encouraged to operate unsafely if they can transfer some of their liability exposure to the Government. Yet, he completely overlooks the fact that the ongoing allocation of liability provides no incentive to the Government to cause its employees to use and maintain contractor-furnished items in a safe fashion.

The Justice Department further refers several times, not too subtly, to the significant drain on the public treasury and the enormous additional costs that would be entailed in enlarging contractor contribution and indemnity rights. I submit that no one can project with absolute certainty what the costs to the Government would be for undertaking these liabilities. What I am saying is that there are meaningful cost savings to be enjoyed by the passage of such legislation. Indeed, some may be intangible or difficult to measure, but we will encourage qualified contractors to compete for Government business, and we will have less chance, therefore, that agencies will wind up with contractors who give less attention to safety or who lack the financial capacity to satisfy claims of injured parties.

We will promote greater safety of contractor products in the hands of the Government, because we will make the Government demand that its employees exercise a higher standard of care on the part of its personnel. We will enable more precise pricing by contractors and, in turn, lower prices to the Government because contractors will more fully appreciate their liability risks.

The Government will be more socially responsible in answering for its fault or for catastrophic losses experienced under its programs.

We urge your support for legislation along the lines we recommend, and I thank you for your attention, Mr. Chairman.

Senator **Grassley**. I appreciate you keeping your testimony within our time parameters. I do have some questions I want to ask you.

Could you provide us with any concrete examples of manufacturing companies refusing a Government contract on account of potential liability?

Mr. **Brown**. Yes, Mr. Chairman. As a matter of fact, my first introduction to this subject arose roughly 7 years ago when TRW was asked to consider competing for a contract for the FAA for a computerized air traffic control system. Upon examining that, it appeared to me that there certainly were liability consequences that could flow from our provision of such a program, and I thereupon undertook to examine our liability exposure. Upon finding that it was unacceptable and on being refused Public Law 85-804 relief, which was not ideal but was about the only option that we had, TRW elected to not compete for that activity.

I feel it is probably fair to say that I think the current FAA office has reconsidered that subject and has shown more willingness to consider the problem. But, indeed, I think that is certainly a particular case in point of which I have personal knowledge.

I do not think that the FAA was unable to find another contractor to do the job, and no great economic loss was sustained by TRW. But I did feel that the position of the FAA was unreasonable because, basically, they were saying: "If we can find any contractor that will not give us this hassle regarding liability, that is the contractor with whom we will do business."

In my view, this was perfectly the situation where, at least in principle, the agency will wind up with perhaps a contractor less safe and less financially responsible and less able to make sure that, indeed, the chances of a liability problem arising are reduced.

Senator **Grassley**. You used the term "willingness." Could you expand on that?

Mr. **Brown**. I am sorry, Mr. Chairman?

Senator **Grassley**. FAA's willingness to do business—I was getting at what you meant by their willingness to work with you.

Mr. **Brown**. Well, they have now explored the possibility of Public Law 85-804 relief. The problems in that, Mr. Chairman, are the fact that that needs an agency head decision in order to approve it. Contracting officers negotiating Government contracts are exceedingly reluctant to kick issues up to the agency head level.

The most serious problem is the fact that Public Law 85-804 relief is subject to a determination that the activity involves extrahazardous problems, and the FAA was reluctant to describe air traffic control as an extrahazardous activity.

Senator **Grassley**. Have you ever received any Public Law 85-804 relief?

Mr. **Brown**. Yes, we have, Mr. Chairman, in terms of some of our Defense activities.

Senator **Grassley**. A little bit of a side issue, and I am not sure it is germane to this, but I remember that in serving on the House Banking Committee, I worked with the Renegotiation Act. And during some of the hearings on that, we ran into some of the problems that the Federal Goverment was causing business, which eventually led to the deterioration of a whole small contractor industrial infrastructure.

I would assume that problems with potential liability would be worse for the small contractor than for the major contractor. Has that had anything to do with reducing our industrial infrastructure for Defense contracting? I assume your corporation does a heck of a lot of Defense contracting.

Mr. **Brown**. Yes, Mr. Chairman, it does. I do not have any statistical data that would back that up, but I would agree with you that I think the problem is particularly profound for the smaller subcontractor and the smaller supplier, and I am sure that this is a problem to them.

Senator GRASSLEY. I would assume your corporation would have to do a lot of its particular Defense work that it does for the Government through subcontractors, would you not?

Mr. BROWN. Correct. We extensively engage subcontractors.

Senator GRASSLEY. Small industry?

Mr. BROWN. Yes.

Senator GRASSLEY. Well, you might look into that, particularly as it relates to this liability problem we have.

Mr. BROWN. Yes. Sometimes, it is difficult in that the subcontractors quite often do not have a focused industry association or representative to represent or really speak for their interests. But we definitely will explore that, Mr. Chairman.

Senator GRASSLEY. OK. At our next hearing, we intend to have a representative from the insurance industry.

Mr. BROWN. Yes.

Senator GRASSLEY. You mentioned in your testimony that affordability and availability, together with cost effectiveness of insurance needs, should be evaluated. Do you believe that much of this problem centers around insurance and not the Government's position on indemnification?

Mr. BROWN. Well, I guess I would answer that by saying I think it is a mixed problem. I think that the Government and the contractor should essentially establish—basically, the agencies, through input from industry, contractors, as well as the insurance companies, should be aware of the insurance markets and what insurance is available. Then, in turn, the agencies should establish what level of insurance is reasonable within a particular contract situation.

Senator GRASSLEY. Is the problem we are addressing today better handled in conjunction with a pending effort to pass a Federal product liability law?

Mr. BROWN. I do not believe so, Mr. Chairman. I might defer largely on that to Mr. Schwartz, who is a recognized expert on that subject and has worked very closely with the Kasten bill. But, basically, Federal uniform product liability, I think, really deals more properly with the commercial sphere and the problems created by divergent State laws, and I think does not deal really with the particular problem we have in the Government contractor context.

Senator GRASSLEY. Well, then, I will ask that of Mr. Schwartz or he can address it when he comes here. That is all of our questions. I want to thank you very much for your participation.

Mr. BROWN. Thank you, Mr. Chairman.

[The prepared statement and submission of Mr. Brown follow:]

Prepared Statement of T. Richard Brown

My name is T. Richard Brown. I am a Vice President in the Law Department of the Electronics and Defense Sector of TRW Inc., with offices in Redondo Beach, California. This segment of TRW has Government contract sales in excess of one billion dollars per year, predominantly advance technology efforts for the military departments, NASA and classified agencies. Because of my familiarity with the growing liability concerns of companies doing business with the Government, I was asked to chair the Task Force on Indemnification of Government Contractors formed by the National Association of Manufacturers (NAM) for the purpose of developing a feasible and sensible solution to these concerns. My appearance is on behalf of the NAM.

The NAM is a non-profit trade association representing approximately 12,000 manufacturing companies, eighty percent (80%) of which are small businesses. The NAM is also affiliated with an additional 158,000 businesses through its Association Department and the National Industrial Council. A significant number of the NAM's members and affiliates are government contractors and subcontractors.

I. THE PROBLEM

The issue we are addressing is the willingness of the Federal Government (1) to accept responsibility for the wrongful acts or omissions of its employees, civilian and military, and (2) to exercise fairness in relationships with private sector contractors and subcontractors who fulfill the demands for a broad array of products and services that permit the Government to function.

Under the current state of the law and executive agency contracting practices, the third party liability exposure assumed wittingly or unwittingly by Government contractors is increasingly onerous. By liability exposure, I am referring to monetary claims that may be asserted by persons harmed when accidents flowing out of Government contract performance cause death, injury or property damage. Over time, a refusal to grapple with this problem -- either on the basis that such liability is a normal cost of doing business or that a resolution can be worried about after the liability is incurred -- will discourage existing contractors from undertaking risky albeit essential programs, and will deter other prospective contractors, particularly small enterprises, from competing for Government work.

Let me give you four brief hypotheticals that I think will help to illustrate the nature of the peril which contractors face. While the possibility of any of these fictional scenarios actually occurring is remote, anyone familiar with Government procurement will tell you that similar or equally unpredictable incidents have happened and will inevitably continue to happen. In these cases, the financial consequences to the contractors are likely to be significant if not ruinous.

(1) A contractor provides a chemical sensor intended to give early warning of unsafe toxicity levels that could result during hazardous waste analyses. The activity is carried out at an Army facility pursuant to an Environmental Protection Agency contract. Due to improper Government maintenance, the sensor malfunctions and a number of military and civilian employees of the Army and EPA sustain serious respiratory injuries. These Government personnel join in filing a legal action against the Government and the contractor. The complaint against the Government is dismissed because the plaintiffs have rights to prescribed relief under Federal disability compensation statutes. Thereafter, a jury finds that the contractor is strictly liable for any harm caused by its sensor and renders judgment against the contractor. The contractor's attempt to have the Government contribute to payment of the judgment is rejected.

(2) A small company specializing in airplane landing gear enters into a subcontract with an aircraft manufacturer that has contracted to furnish the Air Force six wide-body aircraft for transportation of military equipment. The subcontractor criticizes the specifications for the

landing gear, recommending a somewhat more costly approach in order to enhance safety. The Air Force, through its prime, directs the subcontractor to comply with the original specifications, noting that they are based on an earlier generation of freighter aircraft. Following delivery, one of the planes crashes while landing at an Air Force base, killing and injuring the crew as well as a number of Air Force personnel working at a hangar into which the plane skidded. Subsequent investigation attributes the crash to failure of the landing gear. The subcontractor is sued by the injured parties and next of kin. Upon paying numerous judgments and settlements, the subcontractor files its own suit against the Government, alleging that indemnification is justified because it was contractually obliged to deliver the landing gear specified. The subcontractor's action is dismissed on the rationale that this would indirectly circumvent the limitation on the Government's liability to the injured parties in accordance with the Veterans' Benefits Act.

(3) A contractor designs a computerized security system for use by the Department of Energy in controlling access to a strategic petroleum reserve. A terrorist group breaks into the reserve premises and starts a fire and oil spillage that leads to extensive property damage in the surrounding community. It is later ascertained that the computerized system was not operating correctly at the time of the terrorist entry. The contractor becomes the recipient of damage claims which far exceed its net worth.

(4) A subcontractor supplies exotic fuel additives for use in launching missiles. After hundreds of military missile firings over a twenty-year period, it is discovered that several hundred residents of Florida and California beach cities are suffering from a rare chronic disease of the nervous system. A study by the Center for

Disease Control reveals that the disease is caused by exhaust fallout of the missile fuel additives. Throughout the period of performance, the subcontractor carried comprehensive liability insurance with an annual aggregate limit of ten million dollars. Three years after release of the CDC report, claims against the subcontractor total four billion dollars.

The first two examples reflect Federal court decisions which have effectively left contractors "holding the bag" in spite of clear evidence or even a concession that fault on the part of the Government is primarily or exclusively responsible for the liability incurred to Government employees. That is, a contractor is cast in the role of insurer or guarantor of the safe use of its product in the presence of Government military or civilian personnel. This is manifestly not an obligation that a contractor agrees or intends to absorb. Beyond the inequity created, this precedent is counter-productive in that it diminishes the Government's incentive to cause its employees to use and maintain contractor-furnished items in a careful manner. Compare Stencel Aero Engineering Corp. v. United States, 431 U.S. 666, 52 L.Ed. 2d 665 (1977); Thomas v. Lockheed Aircraft Corp., 665 F.2d 1330 (D.C. Cir. 1981), cert. granted sub nom. Lockheed Aircraft Corp. v. United States (No. 81-1181); Henry v. Textron Inc., 577 F.2d 1163 (4th Cir. 1978), cert. denied, 439 U.S. 1047 (1978); Kudelka v. American Hoist & Derrick Co., 541 F.2d 651 (7th Cir. 1976). See also Tobak, A Case of Mistaken Liability: The Government Contractor's Liability for Injuries Incurred by Members of the Armed Forces, 13 Publ. Cont. L. J. 74 (1982).

The latter two hypotheticals relate to what has been characterized as catastrophic liability, where unforeseen events produce claims of a magnitude that threaten the financial survival of the contractor(s) involved as well as the ability of damaged parties to secure relief. See Report of the Commission on Government Procurement, Vol. 4, pp. 99-103 (Dec. 1972). In satisfying the extraordinarily diverse and vital contract requirements of the Government, there arise small but real chances of calamitous incidents or cumulative effects that can generate massive personal and property loss. Rather than ignoring this possibility, or presuming that it can be handled by special relief bills or other after-the-fact ad hoc measures, it is far more expedient and sound to adopt consistent principles in advance of the fortuitous catastrophe. These standards should be aimed at (a) assisting Government suppliers in bearing the burden of unreasonable liability, (b) facilitating prompt and adequate compensation to those who suffer injury or loss, and (c) formulating a comprehensive, uniform national policy separate and apart from considerations of a particular liability occurrence or the status of specific contractors impacted thereby.

II. EXISTING CONTRACTOR OPTIONS

What are the present alternatives open to a Government contractor/subcontractor to ameliorate the escalating third party liability predicament?

Insurance

Liability and property/casualty insurance no doubt play a part, but insurance seldom operates as a complete answer. Questions of availability, affordability and, most importantly, cost effectiveness have to be evaluated. Indeed, the safety record in Government procurement since World War II is exceptionally good. It would not be rational nor in the contractor's or Government's best interest to insure for a "worst case" happenstance in every transaction.

Pricing

In the Stencel case, the Supreme Court observed that Stencel, a small subcontractor, should have taken the liability risk it was compelled to bear (even though the liability was wholly attributable to Government fault) into account when negotiating its contract. The implication is that a contractor (or subcontractor) could or ought to inject some cushion into its price to cover the liability contingency. Those more knowledgeable about Government contracting will recognize this as wholly impractical reasoning. Given (a) the Government's preference for fixed price, advertised contracts which generally result in awards to the lowest bidder, (b) requirements for contractor certifications of cost and pricing data, (c) perennial funding contraints and (d) various "auctioneering" tactics frequently employed by Government negotiators to drive contract prices downward, it is pure naivete to think that contractors could effectively offset the liability element by correspondingly enlarging bid or proposal submissions. Further, while it is common in commercial markets for producers to spread various operating costs across a broad domestic or international marketplace, Government contractors are more circumscribed in their customer base and tend to deliver relatively small quantities of end products.

Special Statutes

Congress has intermittently enacted laws for "special risk" situations, where political pressure was sufficient in terms of the criticality of inducing contractors to perform notwithstanding obvious liability pitfalls. Thus, indemnification has been sanctioned for (a) contractors, subcontractors and licensees involved with nuclear facility construction and operation, 42 U.S.C. § 2210 (Supp. V 1975), (b) research and development contractors of military departments performing "unusually hazardous" risks, 10 U.S.C. § 2354 (1956), (c) contracts furthering the national defense if the work is unusually hazardous or nuclear in nature, 50 U.S.C. §§ 1431-35 (1958), as implemented by Executive Orders 10789 (1958) and 11610 (1971), (d) manufacturers and others engaged in the administration of swine flu vaccine, 42 U.S.C. § 274b. (1978), and (3) NASA agreements with users of a space vehicle, 42 U.S.C. § 2458b. (1979).[1]

Parenthetically, one may query why these select statutory beneficiaries should be any more entitled to indemnification than the entire spectrum of contractors who respond in good faith to the needs of the Government. If the underlying objective is to insulate contractors in potential high liability undertakings, then this protection should not be dependent upon a contractor's ability to fit into insolated niches which Congress has had the foresight to identify.

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[1] In 1972 the Procurement Commission referred to the patchwork group of Federal statutes as "inadequate for relieving the consequences of catastrophic accidents arising from Government-connected programs." Nothing has changed in the interim except that the product liability litigation explosion and creative theories employed by courts to compensate injured parties make it even more probable that a contractor's "deep pockets" will be tapped if its products or services are linked to a liability incident.

Contractor Indemnification

Absent explicit Congressional authorization, there have been only very limited circumstances in which contractors have convinced contracting agencies that it is logical and desirable for them to expressly grant indemnification as part of the contractual bargain. Agencies have historically been reluctant to agree, largely owing to uncertainty or ambiguity regarding the permissibility of consenting to any such commitment. Agencies may feel even more inhibited in the future in light of a recent Comptroller General ruling.

A set of indemnification clauses which for many years have been regularly inserted in both defense and civilian contracts are, in the opinion of the GAO, violative of the Anti-Deficiency Act (31 U.S.C. Section 665) and the Adequacy of Appropriations Act (41 U.S.C. Section 11). Comp. Gen. Decision B-201072 (May 3, 1982). This conclusion applies to Federal Procurement Regulation sections 1-7.204-5 and 1-7.404-9 which provide for Government assumption of uncompensated contractor liability to third persons in cost-reimbursement supply and research and development contracts. Counterpart clauses in the Defense Acquisition Regulation (Sections 7-203.22, 7-402.26) are likewise cited. The Comptroller General stated that these clauses should not be utilized because they purport to obligate Government funds to payment of liabilities undetermined at the time of contracting, irrespective of whether the ultimate cost might exceed available appropriations.

To the extent that contracting agencies react to the GAO holding by conditioning indemnification on the availability of appropriated monies at the time liability arises, contractors will once more be saddled with a speculative, unsatisfactory choice.

In turn, as the contractor community becomes fully cognizant of its ever-expanding vulnerability -- and of the Government's reluctance to acknowledge accountability -- there will be an inevitable adverse impact on the procurement process. Well-advised contractors, especially small business concerns, will simply not be interested when they perceive unbounded liability hazards. Moreover, insofar as agencies elect or feel driven to contract with suppliers who are unconscious of or passive regarding the liability issue, this may result in the Government engaging contractors least able to perform capably or safely, and most likely to lack the resources to respond to claims flowing from a liability occurrence.

This arbitrary and unnecessary impediment to attracting the breadth and best of the nation's industrial base ill serves the public welfare. It is hardly enlightened to declare that the contractor's problem can be obviated by declining Government work.

III. THE PROPOSED SOLUTION

A 1963 study entitled "Catastrophic Accidents in Government Programs" (Legislative Drafting Research Fund, Columbia University) contains the following findings which remain equally cogent today -

> The threat to the public of a catastrophic loss springs directly out of programs initiated and fostered by the Government. Any resulting damage ought clearly to be regarded as one of the costs of these programs. It should be borne, as are all other costs of Government programs, by the nation at large.
>
> * * *
>
> The utilization of contractors by the Government in these fields reflects in part the predominant role of private enterprise in our national life. The Government could, if it saw fit, build its own munitions factories, design and produce its own missiles and spacecraft, and hire its own employees for these purposes rather than engage private contractors to accomplish them. The fact that, as a matter of policy, it operates chiefly through contractors does not deprive these activities of their essentially intimate relationship to the Government. Pp. 75-76.

In other words, it is short-sighted to encumber contractors with liabilities that the Government would almost certainly be compelled to bear but for the intercession of a Government contract.[2]

The only meaningful resolution of the catastrophic liability dilemma, as well as the judicial bar imposed on a contractor's right to recoup payments to Government employees when the Government is wholly or partially at fault in generating the harm, is new remedial legislation.

The Subcommittee on Administrative Law and Governmental Relations of the House Judiciary Committee has been working in this Congress on a bill -- H.R. 1504 -- which would go a long way toward resolving the liability problems described above. The National Association of Manufacturers supports a bill along the lines of H.R. 1504, and the NAM Task Force has worked with the House Subcommittee to shape the legislation into a comprehensive solution.

For your convenience in giving further consideration to development of a Senate bill, I am attaching to this statement a draft bill which has resulted from the NAM Task Force work with the House Subcommittee on H.R. 1504. The draft bill contains features which NAM believes would create a workable and sensible solution to the liability problems.

The draft bill would grant a contractor a right of contribution from the Government equivalent to the proportion that the Government's negligent or wrongful acts or omissions cause the harm which leads to contractor liability. This "comparative fault" concept has been widely accepted and applied in Federal and state courts.

Catastrophic liability is treated by having agencies establish by regulation the level of third-party liability which it would be reasonable for its contractors and subcontractors to bear

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[2] One should not lose sight of the extraordinary leverage which the Government enjoys vis-a-vis its contractors. The Government dictates the overwhelming bulk of the contract terms. While the Government is free to direct unilateral changes, the contractor possesses no concomitant right. Rarely does a contractor control the design or use of a product. Once accepted, the contractor is often unaware of the application of its products and the maintenance, training or performance assessments which the Government conducts.

(through insurance or self-insurance). Government indemnity would be provided for the excess "unreasonable" liability unless attributable to the contractor's fraud, gross negligence or willful misconduct.

Based on my close personal involvement with this subject over the past seven years, I am convinced that this type of legislation will serve a beneficial purpose. It will largely redress the current inequities, foster improved agency dealings with contractors honestly striving to meet their performance obligations, and remove a negotiating obstacle that is otherwise likely to grow to aggravated dimensions as the liability spectre evolves.

I hope this Committee and the Senate will be persuaded that legislation akin to the attached draft bill is warranted and vital to all concerned.

Thank you for the opportunity to present these views.

ENCLOSURE.

97TH CONGRESS
2D SESSION

S. ________

To provide Government contribution and indemnity for suppliers of products and services to the Government in certain cases in which such suppliers may become or have become liable for financial loss with respect to those products and services, and for other purposes.

A BILL

To provide Government contribution and indemnity for suppliers of products and services to the Government in certain cases in which such suppliers may become or have become liable for financial loss with respect to those products and services, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Government Contribution and Indemnification Act."

DECLARATION OF PURPOSE

SEC. 2. It is the purpose of this Act to establish fair and equitable apportionment of liability incurred by suppliers of products and services under contracts with the United States Government by (i) providing contribution for those suppliers in cases in which acts or omissions of employees of the United States Government are wholly or partially the cause of the suppliers' liability and (ii) providing complete indemnity for those suppliers against unreasonable liability arising from such contracts.

DEFINITIONS

SEC. 3. As used in this Act --

(1) the term "supplier" means any person who has contracted with the United States Government to supply a product or service and such person's subcontractors and suppliers at any tier for such purpose;

(2) the term "person" means any individual, corporation (excluding a wholly owned corporation of the United States Government), company, foundation, association, organization, firm, partnership, society, charitable institution, or State or local unit of government;

(3) the term "claimant" means any person who asserts a claim which gives rise or may give rise to liability of a supplier;

(4) the term "State" includes the District of Columbia and all territories or possessions of the United States;

(5) the terms "United States Government" and "contracting agency" mean the federal executive agencies and departments, the federal military departments (including any unit or part of the National Guard of any State), independent establishments of the United States, and corporations primarily acting as instrumentalities or agencies of the United States;

(6) the term "liability" means any financial loss or obliga-

tion incurred by a supplier, including any moneys legally owed by a supplier to claimants as a result of final judgments of courts of law, legally binding settlements, or legally binding arbitration decisions, resulting from harm or claims of harm arising out of, based upon, or associated with products or services which have been, are being, or will be supplied to any person or to the United States Government pursuant to a contract between the United States Government and a supplier;

(7) the term "harm" means (a) damage to or loss of use of property; (b) personal physical injury, illness, or death; (c) mental anguish or emotional distress resulting from an occurrence of personal physical injury, illness, or death; and/or (d) financial detriment, including loss of revenue or profits or other economic loss;

(8) the term "unreasonable liability of the supplier" means liability that has been or may be incurred in an amount above the level of liability set forth in regulations of a contracting agency; and

(9) the term "fault" means acts or omissions that are in any measure negligent or wrongful with regard to the financial liability or harm incurred by a supplier or claimant.

EXCLUSION OF EXTENSION OF STATUTES OF LIMITATION

SEC. 4. Section 205 of the Soldiers and Sailors Civil Relief Act of 1940 (Section 525 of Title 50, United States Code App.) does not affect any limitation on the filing of an action or other proceeding against a supplier of a product or service to the United States Government to enforce any liability of such supplier with respect to that product or service.

GOVERNMENT CONTRIBUTION TO SUPPLIERS

SEC. 5. (a) The United States Government shall provide contribution to a supplier for liability which it incurs arising out of, based upon, or associated with contracts with the United States Government for the supply of a product or service to any person or to the United States Government. Such contribution shall be in an amount of money equal to that proportion of the liability of the supplier which corresponds to the proportion that the United States Government's fault bears to the total fault of the supplier and the United States Government in causing the harm which gives rise to the supplier's liability. Such contribution shall not be provided with respect to any amount of liability which constitutes unreasonable liability for which the supplier is otherwise entitled to receive complete indemnification pursuant to Section 6 of this Act.

(b) A supplier shall give prompt written notice to the Attorney General of the United States and the contracting agency of any known action or claim filed or made against the supplier with respect to which the supplier may seek contribution under this Act. Such written notice shall be sent as promptly as possible, but in no event later than 90 days after the supplier obtains knowledge of an action or claim against it. Except as otherwise directed, the supplier shall promptly furnish to the Attorney General and the contracting agency a copy of all pertinent papers received by the supplier or filed with respect to such actions or claims. The contracting agency, in consultation with the Attorney General, shall make reasonable efforts to resolve requests by suppliers for contribution without the necessity for litigation.

(c) Any supplier which has not received the contribution to which it believes it is entitled under subsection (a) of this section may bring a civil action for contribution against the United States Government. Such an action may be brought (i) in any district court of the United States for a judicial district in which the supplier resides, in which the act or omission complained of occurred, or in which is pending a civil action against the supplier which may give rise to liability, or (ii) in any state court in which is pending a civil action against the supplier which may give rise to liability.

(d) Upon certification by the Attorney General that the liability for which the supplier seeks contribution may constitute liability within the meaning of Section 2(6) of this Act, any such civil action commenced in a state court shall be removed, along with any related pending action by a claimant, without bond at any time before a trial on the merits by the Attorney General to the district court of the United States for the district and division embracing the place wherein the state court action is pending. Should a United States district court determine on a hearing on a motion to remand held before a trial on the merits that the action by a claimant against a supplier so removed does not involve liability within the meaning of Section 2(6) of this Act, such action shall be remanded to the state court.

(e) Civil actions for contribution shall be tried without a jury. In determining the liability of the United States Government for contribution to a supplier, the official record of any prior court or arbitration proceeding which resulted in the supplier's liability shall be admitted into evidence. Any finding in such record as to the fault of the United States Government with regard to the claimant's harm shall not be binding on the court unless the United States Government was a party to the previous court or arbitration proceeding. In determining the proportionate fault of the United States Government and the supplier with regard to the harm from which the supplier's liability arises, the court shall consider such additional evidence of fault as may be introduced by the parties in accordance with the Federal Rules of Evidence. In determining proportionate fault, the court may consider all relevant factors and shall consider the following specific factors:

(1) the nature of contract provisions or specifications associated with acts or omissions contributing to the harm, the relative responsibility of the United States Government and the supplier for the existence of such provisions or specifications, and the relative degree of knowledge, skill, and expertise of the supplier and the United States Government as to potential harm which might be associated with contract performance or non-

performance under such provisions or specifications;

(2) the existence of officially promulgated standards of the United States Government which are associated with acts or omissions contributing to the harm;

(3) the degree to which products or services furnished by the United States Government to the supplier under the contract are associated with acts or omissions contributing to the harm, and the relative degree of knowledge, skill, and expertise of the supplier and the United States Government as to potential harm which might be associated with use of such products and services;

(4) acts or omissions in performance of the contract by employees of the supplier or the United States Government which contribute to the harm, and the relative responsibility of the supplier and the United States Government for the occurrence of such acts or omissions; and

(5) the degree of control or care exercised by the United States Government in the use, application, and maintenance of products or services after delivery by the supplier.

(f) An action under subsection (c) of this section shall be barred unless it is filed within two calendar years from the date liability is incurred by the supplier.

GOVERNMENT INDEMNIFICATION OF SUPPLIERS

Sec. 6. (a) The United States Government is authorized on such terms and to the extent it deems appropriate to require, as part of any government contract, that a supplier maintain private insurance and/or self-insurance against liability the supplier may incur arising out of, based upon, or associated with products or services supplied in the performance of such contract. Nothing herein shall alter or limit any rights or procedures available to suppliers by which reimbursement may be obtained under a contract for the cost of insurance maintained by the supplier for liability arising out of, based upon, or associated with products or services supplied in the performance of the contract.

(b) The United States Government is authorized on such terms and to the extent it deems appropriate to agree in writing, as part of any government contract, or any modification thereto, that the United States Government will indemnify, defend and hold harmless a supplier for all or part of any liability the supplier has incurred or may incur arising out of, based upon, or associated with products or services supplied in the performance of such contract, provided that in no event shall a contractual agreement for indemnification alter or limit a supplier's entitlement to contribution pursuant to subsection (a) of Section 5 or to indemnification pursuant to subsection (c) of this section.

(c) Upon application by a supplier, the head of the contracting agency (or his designee) shall determine, after opportunity for a hearing (in accordance with Section 554 of Title 5, United States Code, but without regard to subsection (a)(4) of such section), whether such contract has caused unreasonable liability of the supplier. If the head of the contracting agency determines that unreasonable liability of the supplier has occurred, the United States Government shall agree or undertake to indemnify the supplier for all unreasonable liability, provided that no indemnity shall be paid for liability resulting from fraud, gross negligence, or intentional misconduct of a supplier's directors or officers or of a supplier's managers, superintendents, or other equivalent representatives who have supervision or direction of (i) all or substantially all of the supplier's business, (ii) all or substantially all of the supplier's operations at any one plant or separate location in which a contract with the United States Government is being performed, or (iii) a separate and complete major industrial operation in connection with the performance of a contract with the United States Government. If the head of the contracting agency (or his designee) determines that the supplier is not entitled to indemnity, the supplier may obtain review of such determination by filing, not later than 30 days from its receipt of such determination, a petition for review in the United States Court of Claims. The Court of Claims shall conduct such proceedings pursuant to its rules of procedure as may be necessary to determine whether or not the determination is in accordance with the rights and procedures provided by this Act, and shall issue a final decision affirming or reversing such determination. The findings of the head of the contracting agency (or his designee) with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive.

(d) Not later than one calendar year from the date this Act is signed into law, each contracting agency, in accordance with Section 553 of Title 5, United States Code, and after opportunity for hearing, shall promulgate regulations establishing levels of liability to be used in determining whether unreasonable liability of the supplier has occurred with regard to any contract of the agency. In promulgating such regulations, each contracting agency shall consider, without limitation, the following factors: (1) the size and nature of the agency's contracts, (2) the size and economic position of the agency's suppliers, (3) the risks of liability generally associated with the agency's contracts, (4) the cost, terms, and availability of private insurance throughout the period during which liability may be incurred by suppliers, (5) the ability of suppliers to self-insure to reasonable levels of coverage, and (6) any other factors bearing on a determination of reasonable levels of liability to be used in determining unreasonable liability of the supplier.

(e) The provisions of the United States Code at Title 10, Section 2354 are hereby repealed. Section 241(a)(7) of Title 42, United States Code, is hereby amended to delete the reference to Section 2354 of Title 10, United States Code.

PAYMENTS

Sec. 7. (a) Notwithstanding the provisions of Section 665 of Title 31 or Section 11 of Title 41, United States Code, contracting agencies are hereby authorized to make contribution or indemnification payments pursuant to Sections 5 and 6 from (i) funds obligated for the performance of the contract from which the supplier's liability arises; (ii) funds currently available for contracts of the nature of the contract from which the supplier's liability arises, and not otherwise obligated; (iii) funds specifically appropriated for such payments; and/or (iv) funds appropriated pursuant to section 724(a) of Title 31, United States Code.

(b) The Supplemental Appropriation Act, section 724(a) of Title 31, United States Code, is hereby amended by adding the words "and Sections 5 and 6 of the Government Contribution and Indemnification Act" after "or 2677 of Title 28."

SETTLEMENTS

Sec. 8. Any liability incurred by a supplier pursuant to settlement of a claim against it shall be subject to contribution under subsection (a) of Section 5 or indemnity under subsection (c) of Section 6 only to the extent such settlement is reasonable under the circumstances or the supplier has obtained written approval for the settlement from the Attorney General (or his designee) or from the head of the contracting agency (or his designee).

SMALL BUSINESS CONCERNS

SEC. 9. The Attorney General and the contracting agencies shall give priority of consideration, on an expedited basis, to requests for contribution, applications for indemnification, and requests for approval of settlements submitted on behalf of any supplier which is a small business concern as defined in regulations adopted by the Small Business Administration pursuant to the Small Business Act. The district courts of the United States shall give priority of consideration, on an expedited basis, to any civil action brought on behalf of any such small business concern under Section 5(c) of this Act. The Court of Claims shall give priority of consideration, on an expedited basis, to any proceedings for judicial review brought on behalf of any such small business concern under Section 6(c) of this Act.

EFFECTIVE DATE

SEC. 10. This Act shall apply with respect to any claim made by a claimant against a supplier on or after the date this Act is signed by the President, provided that the United States Government is authorized to enter into agreements pursuant to subsection (b) of Section 6 of this Act with respect to all claims associated with contracts the performance of which is not complete as of the date this Act is signed by the President.

Senator GRASSLEY. Mr. McCloskey is president of the Electronic Industries Association, and this association represents 380 American companies. Most of these companies make and sell component parts, equipment and systems for consumer, industrial, and Government uses. Other companies in the association conduct research and development or provide contractual services for training in electronics.

We are pleased that you could join us, Mr. McCloskey, and I would ask you to proceed as you see fit.

STATEMENT OF PETER F. McCLOSKEY, PRESIDENT, ELECTRONIC INDUSTRIES ASSOCIATION, WASHINGTON, D.C.

Mr. McCLOSKEY. Thank you, Mr. Chairman. Let me begin first by expressing our gratitude to you for focusing the attention of this subcommittee on what we consider to be a very important problem of product liability.

We gave testimony before the Administrative Law and Governmental Relations Subcommittee of the House Judiciary Committee last year in support of H.R. 1504, which dealt with essentially the same subject as you are addressing here today. We said then that there was an urgent need for legislation which would make a well-reasoned, workable and fair allocation of liability risks associated with a contractor's performance under a Government contract or subcontract.

We pointed out then that the problem had a long pendency, going back over 20 years. Unfortunately, since then, nothing to remedy the problem has occurred. Indeed, the only bright spot is that we survived another year and are still around to complain and urge that something be done.

The problem, as we see it, is that the Government's prime and subcontractors may be held financially responsible for catastrophic accidents arising out of Government programs and activities which are beyond their ability to cover with reasonably available insurance. They may be compelled to shoulder this burden even though the Government itself was responsible for the accident.

Such a grossly unfair situation results from the courts' continually provictim liberalization of product liability doctrines and the sovereign immunity of the Federal Government which continues to insulate it from suit in many accident situations, especially where the plaintiff sues on a no-fault theory.

As has been recognized and agreed to by every task force and study group that has considered the problem, current statutory authority is inadequate to solve this problem and new legislation to indemnify contractors is needed. Such was the conclusion and recommendation of the Columbia University study group in 1963, and such was the conclusion and recommendation of the U.S. Government Procurement Commission which rendered its report to the U.S. Congress in 1972. Other groups of scholars and experts have addressed the problem over the last two decades and all have reached the same conclusion.

Obviously, when a problem is around for such a long time and apparently everyone agrees on what should be done, it is reasonable to ask why nothing has been done. I have asked myself this question and I have asked the leading experts who have studied the problem from our member companies.

Frankly, there does not seem to be any really clear reason why this problem has festered so long. Sure, there may be quibbles and quarrels as to just how the problem should be resolved. How do you determine when there has been a catastrophe? How much insurance is practically available? How should the Government indemnification scheme work? It has been this sort of thing for 20 years.

There has been draft after draft of proposed legislation. Indeed, some of them, like H.R. 1504 and its predecessor, H.R. 5351, have even been introduced and have been the subject of congressional hearings. So while I compliment the subcommittee for its interest in the subject, I appeal to you to have the perseverance to stick with the task and see it through to some positive results. A resolution of this problem is long overdue.

While the concerns and perspectives of the firms making up the membership of the Electronic Industries Association may not be 100 percent congruent with those of all other Government contractors, we strongly believe that everyone would agree that the needed legislation should encompass four or five basic conceptual requirements. In marshalling these recommendations, we have strived to keep in mind and to balance the interests not only of our members but also the Government and the injured victims of accidents.

We make the following recommendations. Legislation should be drawn up and passed which would recognize that some governmental programs entail the possibility of liability for accidents which may be beyond the practical ability of a Government contractor to bear. It is neither a reasonable nor a fair answer to say that such a contractor deserves to go under, especially when one considers the very strong likelihood that the basis for such liability will be the doctrine of strict tort liability—a doctrine which does not require a showing of fault on the part of the defendant.

It is especially noteworthy, I think, that no-fault theories are not actionable against the U.S. Government. The Supreme Court has ruled that the U.S. Government cannot be sued on a no-fault theory. It seems to me that if a contractor has tried to the best of its ability to handle such risks in a prudent and business-like fashion, the end result of his willingness to help with the Government's business should not be bankruptcy.

But such is a very probable outcome where the risks attendant to a Government-sponsored activity result in accidental damages of a magnitude beyond the protection of reasonably available insurance. Under existing law, contractors involved in governmental activities may find themselves solely responsible for a catastrophic accident which causes damages of a magnitude never encountered in nongovernmental undertakings.

This is because the Government undertakes things which are seldom or never undertaken by the private sector—things like space activity and air traffic control. When the Government undertakes activities which occasion risks beyond reasonably available insurance, it should indemnify its contractors not only for the sake of equity of treatment to its contractors but for the fair treatment of the victims of the accident as well.

Whether or not one agrees with all the provictim liberalization of product liability doctrines as they have been enunciated by the courts over the last few decades, I think that most of us would agree that the victims of an accident in a Government-sponsored activity should not have their remedy dependent on the size or the solvency of a contractor and the willingness of the insurance industry to underwrite the total risks attendant to such activity. Legislation providing for indemnification of Government contractors for catastrophic liability beyond reasonably available insurance should be enacted.

Two, the legislation should provide that whether a catastrophe has occurred or not shall be determined by an ad hoc decision by the President. Congress may wish to specify threshold criteria. For example, the legislation could define catastrophe in terms of an accident which will probably occasion damages beyond $10 million.

The legislation should provide indemnification for contractors or subcontractors involved with any governmental activity which gives rise to a catastrophic accident. Existing indemnification authority is available only to certain departments or agencies and only for certain specified risks. This piecemeal approach is neither logical nor fair and should be replaced by a clear, equitable, overall policy.

The indemnification should be provided when a contractor can show that it availed itself of all the insurance reasonably and practically available to it, unless a lesser amount is agreed to by the Government before the accident. I realize that trying to set up a mechanism to determine the amount of reasonably available insurance has been a vexing problem and that many efforts have been made to stipulate in advance a rubric for determining this threshold.

Frankly, I do not have a magic answer. As a suggestion, though, you may wish to delegate the question for decision by the agency or department involved. In any event, some reasonable approach should be adopted rather than leave the enactment of this urgently needed legislation floundering because of a difficulty in determining what the indemnification threshold should be.

The legislation should be self-executing; that is to say that the indemnification should be automatic if it is determined that the accident arose out of a governmental activity and that the damages are beyond the coverage of insurance reasonably available to the contractor who may be legally liable.

I do not come here today professing to be an expert on product liability or Government contract law, but as a spokesman for a portion of American business which, as contractors and subcontractors, is frequently involved in helping carry out vital national programs.

These companies and their technical and productive genius are a most vital asset. The people who work and run these businesses are not and have never been reluctant to take up the challenges of making important things happen. But by the same token, they are careful and prudent, too.

It is a cause for grave concern, it seems to me, when it becomes apparent that some of the best and smartest managers of these firms find that the risks of doing business with the Government are so great that they decide to avoid such business. I submit that we all lose a lot when that happens, but it is happening now and the situation will get much worse when, God forbid, a catastrophe in a Government program does occur and a company is badly bruised or goes under as a consequence.

I believe it is grossly unwise to just wait for a catastrophe to happen and, in the interim, to depend on the ignorance or a willingness to shoulder inordinate and unfair risks when selecting companies to carry out national projects. Any short-term advantage to the Government by continuing to have its contractors and subcontractors bear the risks of uninsurable third party liability is far outweighed by the long-term disadvantages flowing from discouraging the best firms from doing business with the Government and, in the event of an accident, the failure of a business and the lack of a remedy for the victims.

From everything I hear, it is tough doing business with the Government. Government contracts are complicated and the terms and conditions are mostly dictated by the Government. The bureaucracy and redtape has become more and more onerous over the years until now, aside from any issue of third party liability, there is enough disincentive to discourage a businessperson from entering or remaining in the marketplace.

I urge you to work to enact the legislation, and I urge you to do that because I think, as we stated earlier, we have got to use our best skills in carrying out Government programs.

In closing, I would only reiterate that final resolution of the problems described in various testimonies today is essential. All parties to Government contracting—the contractors, the Government and the general public—would be well served by appropriate legislation.

I would be glad to respond to your questions, Senator.

Senator **Grassley**. Yes; I have about three. But before I ask the questions, much of your testimony dealt with the question of catastrophic risk, and legitimately so. I suppose I want to interject here that it is often hard to label what is catastrophic because in so many of those instances, it is hard to determine the cause of the catastrophe itself, or then trying to relate responsibility.

Can you provide specific examples of instances where Government agencies have refused to make use of Public Law 85-804 to indemnify contractors?

Mr. McCloskey. I think the most glaring example has been the past action of the FAA that was cited by a previous witness. That seems to be changing in this particular circumstance, but I think it is indicative of the kind of exposure that businessmen have had to address. If they wanted to do business, they either had to be ignorant of the risk or prepared to take the risk, to the jeopardy of their stockholders and their employees, and I think that is just too unreasonable a risk to bear.

Senator Grassley. If you want to submit any more examples that you may not immediately be aware of but that your staff or organization might be aware of, it would be helpful having those in writing for the record.

Mr. McCloskey. The difficulty is identifying what is potentially catastrophic. It is much easier in the case of the FAA, but in almost any government procurement where there is going to be extensive utilization of a product in a hazardous environment, there is a potential for some sort of catastrophe. It is just not easily identified.

What has happened to date is the companies either have said, "Yes, I will play Russian roulette; I will do business with the Government without liability protection beyond what I normally bear," or they try to get additional liability insurance. But if the factors of cost evaluated by the Government are whether or not a company is adequately insured, I have not been aware of that.

Senator Grassley. Do you know to what extent Public Law 85-804 and 10 U.S.C. 2354 have been employed in providing contractual indemnification?

Mr. McCloskey. I do not have any data on that, Senator.

Senator Grassley. Well, again, if you do have some available other than presently, give it to us in writing.

Last, should an omnibus indemnification statute replace all of the existing indemnification statutes? In other words, we would have one composite affecting——

Mr. McCloskey. You are not addressing catastrophic, but the general problem of preemption of State liability laws?

Senator Grassley. We are addressing catastrophic.

Mr. McCloskey. I am in favor of an omnibus statute on catastrophic liability that fairly allocates the risks and makes it clear what burdens need to be borne by the industry as well as what will be borne by the Government.

Senator Grassley. Since you answered that in the positive, then I guess I would like to have you at this point in the record repeat your judgment of what the term catastrophic encompasses.

Mr. McCloskey. Well, the criteria that we have used is where liability is in excess of reasonably available insurance protection for the contractors themselves, where that potential liability is greater than that amount. Now, in a given case, it may be $500 million; in another case, it may be $20 million.

The Government can set that liability level as it chooses. It seems to me it is the only fair way to operate because to accept as a competitive bid a bid from a company that does not have adequate liability insurance and yet has its obligations to protect potential victims, against one who has adequate liability insurance, obviously weights it in favor of the one who does not because he does not have to pay those additional premiums.

Senator **Grassley**. Thank you for your testimony.

Mr. **McCloskey**. Thank you.

[The prepared statement and submission of Mr. McCloskey follow:]

PREPARED STATEMENT OF PETER F. MCCLOSKEY

I am Peter F. McCloskey, President of the Electronic Industries Association (EIA). Our Association is composed of over 350 firms manufacturing a wide variety of sophisticated electronic products for use in the home, business, and in government applications. Many of our members are involved in Federal Government contracting and are deeply involved as contractors or subcontractors in programs related to defense, space exploration, and other procurement areas. A summary EIA fact sheet is attached to copies of my testimony.

We compliment the Subcommittee and you, Senator Grassley, for focusing on the problem of Government Contractors product liability risks and indemnification.

As you know, we gave testimony before the Administrative Law and Governmental Relations Subcommittee of the House Judiciary Committee on March 19, 1981 in support of H.R. 1504 which dealt with essentially the same subject as this subcommittee is addressing. We said then that there was an urgent need for legislation which would make a well-reasoned, workable and fair allocation of liability risks associated with a contractors' performance of work under a Government contract or subcontract. We gave our analysis of the problem and our reasons for our position. We pointed out then that the problem had a long pendancy--going back over twenty years. Unfortunately, since then, nothing to remedy this problem has occurred. Indeed, the only bright spot is that we have survived another year and a half and are still around to complain and urge that something be done.

To state it briefly for this Subcommittee, the problem as we see it, is that Government prime and Subcontractors may be held financially responsible for catastrophic accidents arising out of Governmental programs and activities which are beyond their ability to cover with reasonably available insurance. They may be compelled to shoulder this burden even though the Government itself was responsible for the accident. Such a grossly unfair situation results from the Courts' continuingly pro-victim liberalization of product liability doctrines and the sovereign immunity of the Federal Government which continues to insulate it from suit in many accident situations especially where the plaintiff sues on a no-fault theory.

As has been recognized and agreed to by every task force and study group to consider this problem, current statutory authority is inadequate to solve this problem and new legislation to indemnify Government Contractors is needed. Such was the conclusion and recommendation of the Columbia

University Study Group in 1963[1], and such was the conclusion and recommendation of the U.S. Government Procurement Commission which rendered its Report to the U.S. Congress in 1972. Other groups of scholars and experts have addressed the problem over the last two decades and all have reached the same conclusions.

Obviously, when a problem is around for such a long time and apparently everyone agrees on what should be done, it is most reasonable to ask why nothing has been done. I've asked myself this question and I've asked the leading experts who have studied the problem for our member companies. Frankly, there doesn't seem to be any really clear reason why this problem has festered so long. Sure, there may be quibbles and quarrels as to just how the problem should be resolved. How do you determine when there has been a castrophe? How much insurance is practically available? How should the Governmental indemnification scheme work? etc. etc. etc. It has been this sort of thing for twenty years!

There has been draft after draft of proposed legislation. Indeed, some of them, like H.R. 1504 and its predecessor H.R. 5351 in the 96th Congress, have even been introduced and have been the subject of Congressional hearings. So while I compliment the Subcommittee for its interest in this subject, I appeal to you to have the perserverance to stick with the task and see it through to some positive results. A resolution of this problem is long overdue.

While the concerns and perspectives of the firms making up the membership of the Electronic Industries Association may not be one hundred percent congruent with those of all other Government Contractors, we strongly believe that everyone would agree that the needed legislation should encompass four or five basic conceptual requirements. In marshalling these recommendations, we have strived to keep in mind and to balance the interests not only of our members but also the Government and the injured victims of accidents. Based on this preamble, we make the following recommendations:

1. Legislation should be drawn up and passed which would recognize that some governmental programs entail the possibility of liability for accidents which may be beyond the practical ability of a Government contractor to bear. It is neither a reasonable nor fair answer to say that such a contractor deserves to go under, especially when one considers the very strong liklihood that the basis for

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[1] The Legislative Drafting Research Fund of Columbia University produced a comprehensive report in 1963 entitled "Catastrophic Accidents in Government Programs".

such liability will be the doctrine of strict tort liability, a doctrine which does not require a showing of fault on the part of the defendant.

It is especially noteworthy, I think, that such no-fault theories are not actionable against the United States Government! The Supreme Court has ruled that the U.S. Government cannot be sued on a no-fault theory.[2/] It seems to me that if a contractor has tried to the best of its ability to handle such risks in a prudent and business-like fashion, the end result of his willingness to help with the Governments' businesses should not be bankruptcy. But such is a very probable outcome where the risks attendant to a government sponsored activity result in accidental damages of a magnitude beyond the protection of reasonably available insurance. Under existing law, contractors involved in Governmental activities may find themselves solely responsible for a catastrophic accident which causes damages of a magnitude never encountered in non-governmental undertakings. This is because the government undertakes things which are seldom or never undertaken by the private sector--things like space activity, and air traffic control for examples. When the Government undertakes activities, which occasion risks beyond reasonably available insurance, it should indemnify its contractors not only for the sake of equity of treatment to its contractors but for the fair treatment of the victims of the accident as well. Whether or not one agrees with all the pro-victim liberalizations of product liability doctrines as they have been enunciated by the Courts over the last few decades, I think that most of us would agree that the victims of an accident in a Government sponsored activity should not have their remedy dependent on the size or the solvency of a contractor and the willingness of the insurance industry to underwrite the total risks attendent to such activity. Legislation providing for indemnification of Government Contractors for catastrophic liability beyond reasonably available insurance should be enacted.

2. The legislation should provide that whether a catastrophe has occurred or not shall be determined by an ad hoc decision by the President. Congress may wish to specify threshold criteria, for example, the legislation could define "catastrophe" in terms of an accident which will probably occasion damages beyond ten million dollars.

3. The legislation should provide indemnification for Contractors or

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2/ Nelms v. Laird 406 U.S. 797 (1972).

subcontractors involved with any Governmental activity which gives rise to a catastrophic accident. Existing indemnification authority is available only to certain Departments or Agencies and for only certain specified types of risks. This piece meal approach is neither logical nor fair and should be replaced by a clear, equitable overall policy.

4. The indemnification should be provided when the Contractor can show that it had availed itself of all the insurance reasonably and practically available to it unless a lesser amount is agreed to by the Government before the accident. I realize that trying to set up a mechanism to determine the amount of reasonably available insurance has been a vexing problem and that many efforts have been made to stipulate in advance a rubric for determining this threshold. Frankly, I don't have any magic answer. As a suggestion, though, you may wish to delegate the question for decision by the agency or department involved. In any event, some reasonable approach should be adopted rather than leave the enactment of this urgently needed legislation flounder because of a difficulty in determining what the indemnfication threshold to be.

5. The legislation should be self executing. This is to say that the indemnification should be automatic if it is determined that the accident arose out of a Governmental activity and that the damages are beyond the coverage of insurance reasonably available to the contractor or subcontractor who may be legally liable.

I do not come here today professing to be an expert on Product Liability or Government Contract Law, but as a spokesman for a portion of American business which, as contractors and subcontractors, is frequently involved in helping carry out vital national programs. These companies and their technical and productive genius are a most vital national asset that can be counted on to achieve truly wondrous goals. The people who work for and run these businesses are not and never have been reluctant to take up the challenges of making important things happen, but by the same token, they are careful and prudent, too. It is cause for grave concern, it seems to me, when it becomes apparent that some of the best and smartest managed of these firms find that the risks of doing business with the Government are so great that they decide to avoid such business. I submit that we all lose a lot when that happens, but it is happening now, and the situation will get much worse when, God forbid, a catastrophe in a Government program does occur and a company is badly bruised or goes under as a consequence. I believe it is grossly unwise to just wait for a catastrophe to happen and in the interim to depend on the ignorance or a willingness to shoulder inordinate and unfair risks when selecting companies to carry out national projects. Any short term advantage to the Government by continuing to have its contractors and subcontractors bear the risks of uninsurable third party liability is far outweighted by the long term disadvantages flowing from discouraging the best firms from doing business with the Government and, in the event of accident, the failure of a business and the lack of remedy for the victims.

From everything I hear, it is tough doing business with the Government. Government Contracts are complicated and the terms and conditions are mostly dictated by the Government. The bureaucracy and red tape have become more and more onerous over the years until now--aside from any issue of third party liability--there is enough disincentive to discourage a businessperson from entering or remaining in this marketplace. I urge you to work to enact the legislation meeting the requirements I stated earlier so that we can be sure of using our best skills in carrying out our Government's programs.

In closing, I would only reiterate that final resolution of the problems described in various testimonies here today is essential. All parties to government contracting--the contractors, the Government, and the general public--would be well served by appropriate legislation.

I will be glad to respond to your questions.

Electronic Industries Association

1982

The Electronic Industries Association (EIA) represents 380 American companies. Most make and sell component parts, equipment, and systems for consumer, industrial, governmental uses. Others conduct research and development or provide contractual services pertaining to electronics.

EIA's membership includes companies of all sizes, ranging from very small, single-product businesses to large, multinational corporations.

The U.S. factory sales of electronic products are estimated at $117 billion in 1981. Over $23 billion of this was exported. That figure would be even higher if the electronic content in such equipment as airplanes and machine tools were to be separately identified.

Electronics manufacturing directly employs 1.6 million Americans. Of those jobs, at least 600,000 are tied to exports.

Last year, while the nation suffered a trade deficit, our industries generated a $4.5 billion trade SURPLUS.

To summarize: ELECTRONIC EQUIPMENT AND COMPONENTS

	1978	1979	1980	1981 (Estimated)
U.S. Factory Sales	$70.5	$85.4	$104.3	$117.0 billion
Exports	13.4	16.7	20.1	23.3 billion
Imports	10.7	11.8	13.1	18.8 billion
Trade Balance	+2.7	+4.9	+6.9	+4.5 billion
Employment	1.292	1.436	1.57	1.61 million in the USA

Whether measured by production, trade or employment, ours continue to be growth industries, and our sector to be one of the major, positive factors in the U.S. economy.

Source: ELECTRONIC MARKET DATA BOOK 1982 published by EIA.

EIA/IBC/3-82 Revision

Senator GRASSLEY. Next, we have two witnesses presenting testimony. Mr. Bud Baird is president of Eaton Corp.'s defense and systems group and accompanying him is James A. Kane, legal counsel for the group's AIL division located in New York.

Eaton Corp. is a worldwide manufacturer of advanced technological products for transportation and industrial markets. It employs about 47,000 people, 33,000 of whom are located in the United States.

Your testimony states that most of your product liability questions arise in the area of your defense and systems work, and I think that the subcommittee will benefit from your experience in that area of contractor potential liability.

I want to note that Christopher Caine, manager of legislative affairs for Eaton, has been most helpful in providing the Chairman and the subcommittee and our staff with information on both sides of this question.

I would like to have you, Mr. Baird, and Mr. Kane, if you are both going to testify, to proceed as you desire and within the confines of what I have already said. Thank you.

STATEMENT OF MELLON C. BAIRD, JR., PRESIDENT, ACCOMPANIED BY JAMES A. KANE, JR., LEGAL COUNSEL, AIL DIVISION, DEFENSE AND SYSTEMS GROUP, EATON CORP.

Mr. BAIRD. Thank you, Mr. Chairman. I think it is appropriate that as a corporation heavily involved in the defense and space worlds of Government contracting that we go right to the issue at hand and give you some real examples of our areas of concern.

I am going to cite four major product areas in which our contracting relationships with the Government, particularly as it regards liability contribution and indemnification, create a potential problem for us.

First, Eaton developed the preamplifier portion of the S-band communications system for the Space Shuttle. This is the primary means of communication between the Shuttle orbiter and ground tracking stations during the ascent, orbital, and entry phases of the mission. This system is so vital to the mission that should a total failure of the S-band system occur after lift-off but before the Shuttle reaches orbit, NASA policy requires that the mission must be aborted.

The liability to which Eaton could be exposed as a result of an aborted takeoff of a Space Shuttle carrying a commercial payload could be enormous. Let us take a satellite communications company as an example. Both the company and its customers could sue Eaton for property and usage loss. We estimate that the potential liability arising from an incident of this kind could run as high as $1 million per day as a result of lost business revenues to the satellite communications company and its customers. In addition, there is the potential liability exposure which could result from the crash of an aborted mission in a populated area.

The second product area also relates to the Space Shuttle. We call it the microwave scanning beam landing system [MSBLS], which we designed and manufactured specifically for the Space

Shuttle. This is the principal guidance system enabling the space vehicle to return to Earth.

A failure of this system which resulted in a crash of the orbiter could expose us not only to the liability affiliated with the loss of business opportunities for future Space Shuttle users and injury to Government employees, but also to the liability of an accident involving civilian personnel and property losses.

A third product area is Eaton's involvement with military avionics and electronic countermeasure systems for the Department of Defense and a vessel traffic control system [VTCS], a system for the Coast Guard. These systems are primary examples of Eaton products which are placed in a potentially high liability situation.

A fourth area already cited by many others is in the area of air traffic control. Our AIL division is the world's largest supplier of air traffic control display and processing systems. We are acutely aware of, and familiar with, the discussions that have taken place this morning.

In this country the FAA procures many such systems for its tower and en route system operations across the country. It is unclear at this point, in our opinion, the extent to which the FAA's December 1981 announcement regarding indemnification of contractors who will participate in the future computer replacement program, will cover Eaton's and other contractors' activities. In any event, at the present time our previously installed and operating systems expose Eaton to liability arising from possible air traffic control system-attributed airline crashes.

Senator, I believe these four specific examples of our various Government contracting product areas demonstrate inherent liability risks and some of our concerns.

I would now like to look at the two basic liability problems resulting from our relationship with the Government: Contribution and indemnification. I would like to more fully describe these to you and present some newly emerging concerns we have as a Government contractor.

First, contractors are exposed to contribution liability problems when their products are purchased by the Government and used primarily by Government employees. The contractor's preclusion from attaining contribution from the Government even when the Government can be shown to be at fault is manifested in the *Stencel* case. This problem is also exemplified by the Federal Employees Compensation Act [FECA] preclusion of suits by Federal employees against the Government but not against manufacturers or contractors.

Despite the Justice Department's stated opposition to any legislative remedy which would "overturn these well-settled and soundly-based" doctrines, the *Stencel* case has been used for years in law schools across the country to show the unfairness of the decision's resulting unshared liability in a tort incident involving the Government.

The second liability problem encountered by contractors concerns the concept of indemnification. The problem has been typified and exacerbated by ad hoc government support for the concept. Public Law 85-804 and Executive Order 10789, which implements its statutory charter, illustrate the highly discretionary factor and the resulting lack of uniformity in governmental procedures regarding which missions are considered worthy of indemnification and which are not.

You asked earlier for examples of confusion, perhaps, in this area, and I would like to quote the current NASA indemnification policy. I believe this is an example of an answer to your specific question.

The NASA policy states:

> It is NASA's firm policy not to use the authority contained in Public Law 85-804. It is also NASA's policy not to indemnify contractors and subcontractors at some time in the future, if and when NASA should be authorized by subsequently enacted legislation to grant such indemnification, or if and when NASA might promulgate for general use an indemnification clause within the limits of existing legal authority.

I go on:

> However, if indemnification authority is subsequently provided to NASA by legislation, NASA will do whatever is permitted by the statute and other available authority to apply its provisions so that all elements of industry similarly situated are treated in the same fashion and that a proper assumption of risks is undertaken by the government, whether such risks arise under contracts in effect or are contemplated in any new contract.

EFFECTS OF PROBLEMS ON GOVERNMENT CONTRACTOR

Our highly advanced technical products placed are generally not used in private markets. We consider this governmental use of Eaton products to be a special product application. Consequently, this kind of product application prohibits, by nature, a manufacturer's ability to use legal liability remedies normally available to it in a commercial setting.

For many years, this special product application liability problem was the only one contractors had to be concerned about because the activity was uniquely governmental. Today, however—and this is where we get into the new area—a more onerous dimension is emerging. As traditionally perceived governmental activities take on a dual role, such as the Space Shuttle carrying contracted commercial payloads, a whole new set of liability problems emerge to confront Government contractors, and we submit, therefore, the Government.

On November 11, 1982, a very short time from now, the Shuttle will inaugurate its dual role. Two commercial communications satellites will be carried aloft and placed into orbit. The Shuttle program will perform this dual function at least 13 more times over the next 3 years. A copy of the NASA launch schedule is attached to my testimony.

In addition to the dual role problems, the contractor's plight of unshared and forced liability is again exemplified in the congressional statute—Public Law 96-48—and NASA's policy of indemnifying Shuttle users but not Shuttle contractors. A reading of the NASA launch agreement for Shuttle activity further depicts the untenable position of manufacturers.

The agreement contains provisions stating that the user waives its right to make a claim against the Government. However, this waiver does not apply to manufacturers of the Shuttle or its components and, consequently, unfairly exposes them to commercial-like liabilities not shared by the Government, even though the Government is integrally involved and accepts this commercial role.

This new dual role exposes Eaton and companies like us to emerging liabilities, heretofore not encountered in normal Government contracting.

In addition to this problem are, our ability to obtain adequate commercial liability insurance at reasonable cost to cover these missions becomes increasingly difficult, and I would like to cite a specific example for you.

As mentioned previously, we made an estimate that a claim could be made as high as $1 million a day for perhaps up to 1 year in the event an orbiter had to abort its mission and return to Earth, and the commercial satellites, therefore, could not be launched in space at that time and a new launch date would have to be set. So, perhaps $1 million a day up to 1 year could be the liability experienced by the contractor.

We asked insurance companies to look at underwriting such a possibility up to $360 million. We found a combine of insurance companies willing to undertake only $50 million, not $350 or $365 million. They required a premium of $10 million per year, with $5 million deductible. This was the only combine we could find that would undertake even any portion of that liability.

POSSIBLE RESOLUTIONS OR REMEDIES

After assessing the risks and avenues of recompense open to Government contractors vis-a-vis contribution and catastrophic liability, Eaton firmly believes a fair and workable legislative remedy is needed to resolve these very real and serious problems.

In expressing our support for a legislative resolution, it should also be stated that the concept and practice of indemnifying Government contractors is not a new one. There is precedence in the Congress and the executive branch for doing so, and we particularly cite the 1972 Commission on Government Procurement and its recommendations H-four and H-five.

There have been many other actions taken confirming the value and need for indemnification such as the 1976 national swine flu immunization program, Space Shuttle user indemnification, this administration's actions regarding the FAA's future air traffic control computer upgrade program, and even an international treaty covering liabilities resulting from spacecraft accidents, which does not apply, by the way, to coverage for U.S. citizens but only for foreign citizens.

Furthermore, it should be said that redress against the Government for comparative fault or contribution is also not new. It currently exists under the Federal Torts Claim Act for third-party suits brought against the Government by a contractor when the third-party is not a Government employee. The seemingly unfair externalization by the Government of its liability/responsibility only exists when a suit involves a military or civilian government employee. Consequently, we believe that any legislative remedy to the current contribution and indemnification problems encountered by Government contractors would merely be an equalizing of tort liability for the Government with what currently exists regarding international treaties and non-Government employee suits.

Some parties will contend that all that is needed to resolve many of the indemnification concerns raised today is a more diligent implementation of Executive Order 10789. However, Eaton's experience, drawn in part from the stated NASA's indemnification policy, has convinced us that this will not likely accomplish the necessary goal.

Congressional review of this serious problem is important and can be beneficial. You are to be commended for sponsoring these hearings today and the hearings you plan to sponsor later. Eaton urges you in Congress to address these concerns that are being raised, and we trust and hope that there will be some form of legislation which will be beneficial, we believe, to both the Government and to Government contractors, and to potential accident victims and to the Nation as a whole.

Thank you for this opportunity to appear, and I would be happy to answer any questions if we can.

Senator **Grassley**. I have a few questions.

Mr. **Baird**. Yes, sir.

Senator **Grassley**. Does Eaton carry insurance with regard to its participation in the space shuttle program?

Mr. **Baird**. The answer to that question is not specifically on the space shuttle program.

Mr. **Kane**. Maybe I might answer that question. Eaton has a general liability policy which would protect us against certain claims such as bodily injury. However, we do not have a policy that would protect us against loss of use or other consequential-type damages.

Senator **Grassley**. I do not know whether this would be information you would want to give, but what do you pay for that policy?

Mr. **Kane**. I do not know.

Mr. **Baird**. I really do not know the amount. I am sure it is substantial.

Mr. **Kane**. Yes.

Senator **Grassley**. Would your board of directors let you give us the information if you had it? If they would, then I guess I would want it. I respect the trade rights there, but if you——

Mr. **Baird**. I will make a specific inquiry, Senator, and if so, I will certainly submit it to you.

Senator **Grassley**. OK. Now, did you state what the amount of that insurance was? Well, of course, you do not have it specifically on the space shuttle.

Mr. **Baird**. I can answer that if you like.

Senator **Grassley**. Well, that will give us the information, then, that we want.

Are you aware of any successful third party suits?

Mr. **Baird**. Successful third party suits?

Senator **Grassley**. Against Eaton.

Mr. **Baird**. No.

Senator **Grassley**. You mentioned in your testimony that statutory implementation of Executive Order 10789 is not the answer to the indemnification problem. Did I interpret your testimony right on that?

Mr. **Baird**. Yes. We believe that the implementation of that order has been left up to individual departments and we are seeing a totally different application across each of the agencies. As a consequence, we feel that even an effort to more delicately implement the Executive order is not really sufficient for a problem of the magnitude that we have been citing.

Senator **Grassley**. OK. Would a statutory implementation of that Executive order be a step in the right direction?

Mr. **Baird**. Yes, sir, it would.

Senator **Grassley**. That is the last question, but this business of cost still bothers me, and I guess it goes beyond just the purpose of this meeting, but it follows up on questions that I had about the renegotiation system that we used to have.

Obviously, any profitmaking corporation has to look ahead to potential suits and liability. Insurance is going to be built into the cost of the contract, I would assume, right? This is not something that any responsible corporation could ignore and just say, "We are going to bid regardless of this?"

Mr. **Baird**. Well, I refer to one of the previous testimonies, but I will be more specific and stick with Eaton Corp. and the Space Shuttle as one of many examples that we could cite.

Our total contracts on the Space Shuttle—and I mentioned two different product areas are very important to the mission of the space shuttle, and have a potential liability in the event of problems. Our total contracts are around $35 million. That is our selling price, obviously not our profit. Profit is a matter of a few percent.

I mentioned earlier that in the one case in which we have done the speculative work on a $1 million a day claim from the loss of the launch of these commercial satellites, the cost of obtaining such insurance, only $50 million worth, is $10 million a year. That is far, far in excess of any profits we would ever hope to make on $35 million worth of Government contracting work.

Now, your question was, does that prevent you from going forward? At this moment in time, Eaton Corp., like most Government contractors, is proceeding without including in its cost of performance any kind of insurance coverage on these very major potential liability problems. I would have to characterize it as a situation in which the clock is ticking, and it would be, in our opinion, a very difficult moment in time for our corporation or any other corporation to face the kind of dollar claims that might ultimately be laid against a corporation under one of these potential situations.

Senator **Grassley**. Well, then the supposition I put forth obviously is not accurate. I guess maybe I just assumed that it was something you had to do. I do not mean to imply that you are irresponsible because you have not, and I suppose I ought to be thankful for the taxpayers that you have not, under those circumstances.

Was this contract competitive bidding?

Mr. **Baird**. Yes, it was.

Senator **Grassley**. So, there was more than one contractor?

Mr. **Baird**. There is more than one contract for each of the two systems.

Senator **Grassley**. Yes. What I mean is was there more than one bidder? There were several bidders?

Mr. **Baird**. Yes, sir, there were several bidders.

Senator **Grassley**. Let me ask you this. Would you suppose that you got the contract, unlike the people who did not get it, because you did not include this in your potential costs and maybe they did?

Mr. **Baird**. I would only have to speculate because we obviously do not know what costs were included.

Senator **Grassley**. I would ask you to speculate.

Mr. **Baird**. On that speculation, I would say that the other corporations who bid also ignored the potential liability problem.

Senator **Grassley**. OK. If we had a sole source situation, do you think the Government in that sole source would recognize this potential liability and let it be built into the contract?

Mr. **Baird**. As a cost element?

Senator **Grassley**. Or do you know of any instances where it has been?

Mr. **Kane**. If I might respond, Senator, normally under Government procurement regulations, the Government does not permit as a cost recovery such contingencies.

Senator **Grassley**. So, you are saying it never has been built in, even in the sole source, or at least not legally?

Mr. **Kane**. I do not think you could do it and be consistent with Government procurement regulations.

Senator **Grassley**. I guess we would have to assume that they are, at least I am——

Mr. **Baird**. Mr. Kane's answer is my answer from a number of years of experience in the field. It would be highly resisted, as a practical matter, by the Government contracting officer as a cost element that is not typically included.

Senator **Grassley**. Well, that is all the questions I have. Thank you very much.

Mr. **Baird**. Thank you, Mr. Chairman.

[The prepared statement of Mr. Baird follows:]

PREPARED STATEMENT OF MELLON C. (BUD) BAIRD, JR.

Good morning Mr. Chairman and members of the subcommittee. My name is Bud Baird and I am President of Eaton Corporation's Defense and Systems Group. Accompanying me today is James A. Kane, Jr., Legal Counsel for the Group's AIL Division located on Long Island, New York. We appreciate this opportunity to appear before you today and present Eaton's views and comments regarding indemnification of government contractors.

Eaton Corporation is a worldwide manufacturer of advanced technology products for transportation and industrial markets. Our headquarters is located in Cleveland, Ohio and we have 170 manufacturing and administrative facilities on six continents. Eaton employs approximately 47,000 people, over 33,000 of whom are located in the 26 states in the United States where we have installations.

Eaton has been in business for more than 70 years and is actively engaged in government contracting. Our increased activity in government contracts arises primarily from our Defense and Systems Group. Many of the products manufactured at our Long Island facilities and at other Eaton plant locations are used by federal agencies in both military and non-military applications. It is these products and our contractual obligations with the government which give rise to our concern regarding this issue.

Let me briefly describe the four major product areas in which Eaton's contracting relationships with the government cause great concern regarding liability contribution and indemnification.

1) S-Band Communications System for the Space Shuttle

Eaton developed the preamplifier portion of the S-Band system for the space shuttle, which is the primary means of communication between the shuttle orbiter and ground tracking stations during the ascent, orbital and entry phases of the mission. This system is so vital to the mission that should a total failure of the S-Band system occur after liftoff, but before the shuttle reaches orbit, NASA policy requires that the mission must be aborted.

The liability to which Eaton could be exposed as a result of an aborted takeoff of a space shuttle carrying a commercial payload could be enormous. Let's take a satellite communication company and its customers as an example. Both the company and its customers could sue Eaton for property and usage loss. We estimate that the potential liability arising from an incident of this kind could run as high as $1 million per day as a result of lost business revenues. In addition, there is the potential liability exposure which could result from the crash of an aborted mission in a populated area.

2) Microwave Scanning Beam Landing System (MSBLS)

The Eaton MSBLS system was designed and manufactured specifically for the shuttle and is one of the principle guidance systems enabling the space vehicle to return to earth. A failure of the system which resulted in a crash of the orbiter could expose us to not only the liability affiliated with the loss of business opportunity for future shuttle users and injury to government employees, but also to the liability of an accident involving civilian personnel and property losses.

3) Military Avionics and Radar Systems

Eaton's involvement with military avionics and electronic countermeasure systems for the Department of Defense (DOD) and Vessel Traffic Control (VTS) systems which we supply the Coast Guard are prime examples of Eaton products in a high liability situation.

4) Air Traffic Control (ATC) Display and Processing Systems

The AIL Division is the world's largest supplier of air traffic control display and processing systems. Eaton ATC systems are procured by the Federal Aviation Administration (FAA) for its operations at major installations across the country. It is unclear at this point the extent to which the FAA's December, 1981 announcement (46 Fed. Reg. 62596-62597) regarding indemnification of contractors who participate in the Computer Replacement Program will cover future Eaton ATC systems. However, currently installed and operating systems expose Eaton to liability arising from possible system-attributed airline crashes.

Senator, these examples of Eaton's government products demonstrate the inherent liability risks and our concerns.

Liability Problems Arising From Government Contracting

I have alluded to two basic kinds of liability problems resulting from our contractual supplier/customer relationship with the government. Let me describe them more fully now and also present some new concerns that we have with government contracting.

First, contractors are exposed to contribution liability problems when their products are purchased by the government and used primarily by government employees. A contractor's preclusion from attaining contribution from the government -- even when the government can be shown to be at fault -- is manifested by the Supreme Court's decision in the 1977 Stencil case (431 U.S. 666) and the confirmation it lends to the 1950 Feres doctrine (340 U.S. 135). This problem is also exemplified by the Federal Employees Compensation Act preclusion of suits by Federal employees against the government, but not against manufacturers or contractors. Despite the Justice Department's stated opposition to any legislative remedy which would "overturn these well settled and soundly based" doctrines, the Stencil case has been used for years in law schools across the country to show the unfairness of the decision's resulting unshared liability in a tort incident involving the government.

A second liability problem encountered by contractors concerns the concept of indemnification. The problem has been typified and exacerbated by ad hoc government support for the concept. Public Law 85-804 and Executive Order 10789, which implements its statutory charter, illustrate the highly discretionary factor and the resulting lack of uniformity in governmental procedures regarding which missions are considered worthy of indemnification and which are not. The current NASA Indemnification Policy, (NASA PR 10.350) further exemplifies contractors' concerns regarding consistent government support for indemnification and the viability of agency implementation of E.O. 10789. It states:

> ... It is NASA's firm policy not to use the authority contained in Public Law 85-804 (50 U.S.C. 1431-1435). It is also NASA's policy not to indemnify contractors and subcontractors at some time in the future, if and when NASA should be authorized by subsequently enacted legislation to grant such indemnification, or if and when NASA might promulgate for general use an indemnification clause within the limits of existing legal authority. However, if indemnification authority is subsequently provided to NASA by legislation, NASA will do whatever is permitted by the statute and other available authority to apply its provisions so that all elements of industry similarly situated are treated in the same fashion and that a proper assumption of risks is undertaken by the government, whether such risks arise under contracts in effect or are contemplated in any new contract.

Both of these problems, contribution and indemnification, are magnified in a sole source contracting situation by the "nature-of-the-mission" problem. Simply stated, this problem requires that the only available supplier engage in a unique supplier/customer relationship whereby the manufacturer is supplying a product to only one buyer (the government), and it is used primarily by government employees. Furthermore, the product is designed and made for a specific governmental function or activity and, therefore, carries with it these various liability problems.

The Effect These Problems Have On Eaton As A Government Contractor

In Eaton's case, our highly technical advanced electronic products manufactured for the government's space shuttle, military avionics, VTS, and ATC activities are generally not used in private markets. This governmental use is a special product application. Consequently, this kind of product application prohibits, by nature, a manufacturer's ability to use legal liability remedies normally available to it in a commercial setting.

For many years this special product application liability problem was the only one contractors had to be concerned about because the activity was uniquely governmental. Today, however, a new and more onerous dimension is emerging. As traditionally perceived governmental activities take on a dual role, such as the space shuttle carrying contracted commercial payloads, a whole new set of liability problems emerge to confront government contractors.

On November 11, 1982, the shuttle is scheduled to inaugurate its dual role. Two commercial communications satellites will be carried aloft and placed into orbit. The shuttle program will perform this dual function at least 13 more times over the next three years. A copy of the NASA launch schedule is attached to my testimony.

In addition to these dual role problems, the contractor's plight of unshared and forced liability is again exemplified in the congressional statute (P.L. 96-48, 42 U.S.C. 2458b) and NASA's policy of indemnifying shuttle users, but not shuttle contractors. A reading of the NASA launch agreement for shuttle activity further depicts the untenable position of manufacturers. The agreement contains provisions stating that the user waives its right to make a claim against the government. However, this waiver does not apply to manufacturers of the shuttle or its components and, consequently, unfairly exposes them to commercial-like liabilities not shared by the government even though the government is integrally involved and accepts this commercial role.

This new dual role exposes Eaton and companies like us to emergir liabilities heretofore not encountered in normal government contracting.

As a result of our inability to obtain contribution and /or indemnification from the government in certain contracting situations, other problems arise as well.

1) Eaton's ability to obtain adequate commercial liability insurance at reasonable cost to cover these missions becomes increasingly difficult.

2) These liability problems, whether advertent or inadvertent, create a disincentive for Eaton to enter into future contractual obligations with the government.

3) These problems can add to the contract costs to the government. If a firm makes the decision to engage in a government contract aware of its inability to recover a proportion of certain outside liability costs, the natural propensity is to try to recoup some of these costs, if possible, in the price of the contract.

4) Finally, and perhaps most importantly from a long-term perspective, there is the chilling effect these liability exposure problems can have on a contractor's, and therefore the government's subcontractor base. Eaton subcontractors are often companies much smaller in size which may not have the financial ability or business reputation to obtain adequate coverage. Consequently, they may be reluctant to engage in government contract work.

Possible Resolutions Or Remedies To The Problem

After assessing the risks and the avenues of recompense open to government contractors vis-a-vis contribution and catastrophic liability, Eaton firmly believes a fair and workable legislative remedy is needed to resolve these very real and serious problems. In expressing our support for a legislative resolution, it should also be stated that the concept and practice of indemnifying government contractors is not a new one. There is precedence in Congress and the Executive branch for doing so and it should be more broadly used as a necessary and fair component of public policy. As has been stated by other witnesses this morning, and touched upon in my statement previously, support for indemnification of government contractors has been well articulated, particularly by the 1972 Commission on Government Procurement (in its recommendations H-4 and H-5). There have been many actions taken confirming the value and need for indemnification such as the 1976 National Swine Flu Immunization Program (P.L. 94-380); space shuttle user indemnification (P.L. 96-48); the recent Administration actions regarding the FAA's ATC upgrade programs, and even an international treaty covering liabilities resulting from spacecraft accidents (e.g. Skylab). This 1972 multilateral treaty (24 U.S.T. 2309) allows residents of foreign countries injured by falling U.S. space debris to collect from the U.S. government without any showing of fault or negligence. Ironically, the U.S. government assumes absolute liability for all damage to foreign governments and nationals caused by the falling space debris, but does not accept this same responsibility when it concerns its own citizenry.

Furthermore, it should be said that redress against the government for comparative fault or contribution is also not new. It currently exists under the Federal Torts Claim Act for third-party suits brought against the government by a contractor when the third-party is not a government employee. The seemingly unfair externalization by the government of its liability/ responsibility only exists when a suit involves a military or civilian government employee.

Consequently, any legislative remedy to the current contribution and indemnification problems encountered by government contractors would merely be an equalizing of tort liability for the government with what currently exists regarding international treaties and non-government employee suits.

Some parties will contend that all that is needed to resolve many of the indemnification concerns raised today by myself and others is a more diligent implementation of Executive Order 10789. However, Eaton's experience, (drawn in part from the stated NASA indemnification policy), has convinced us that this will not likely accomplish the necessary goal. This is primarily due to the propensity of government agencies not to consider activities "unusually hazardous" or worthy of indemnification.

Mr. Chairman, Eaton supports the previous congressional and Commission on Government Procurement efforts in this area. We also support Representative McClory, the House Judiciary Committee and the NAM efforts to carefully draft responsible legislation to resolve the contribution and indemnification problems. We stand ready to work with you and your Senate colleagues in any legislative efforts you may embark upon.

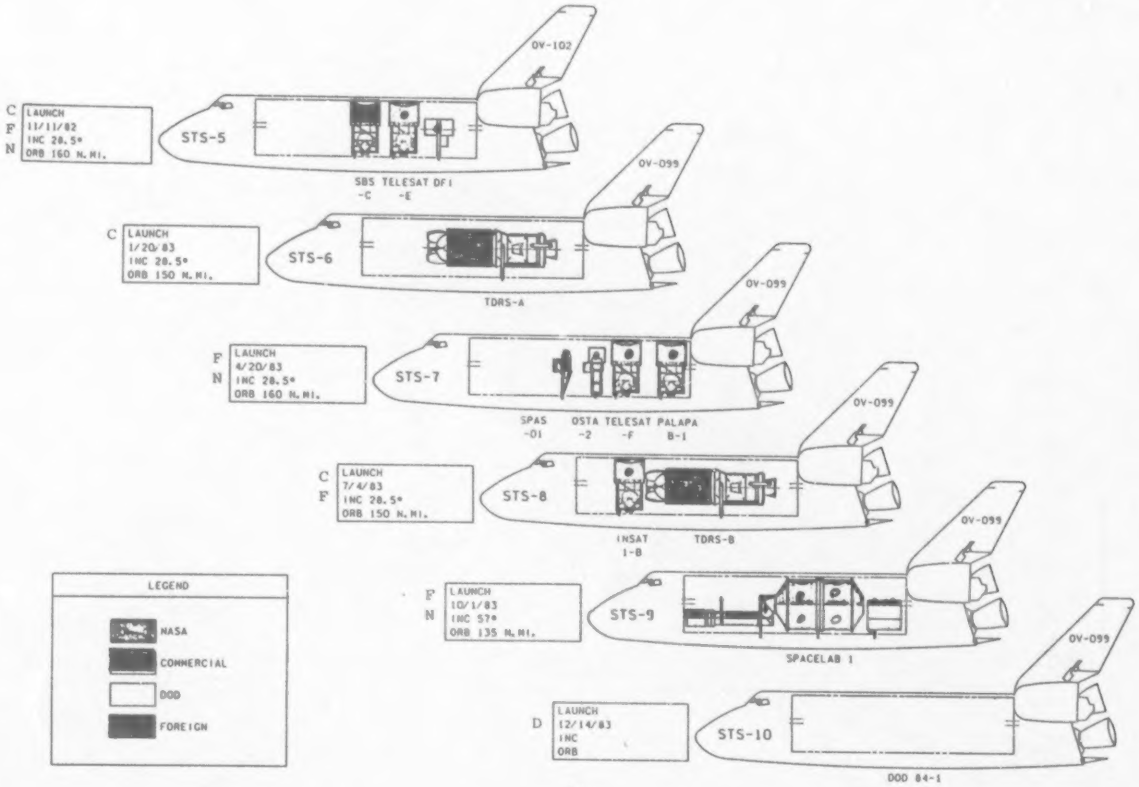
Congressional review of this serious problem is important and can be beneficial. You are to be commended for sponsoring these hearings today. Eaton urges you and Congress to address the concerns that are being raised here today by enacting legislation which will be beneficial to the government, to government contractors, to potential accident victims and to the nation as a whole.

Thank you again for the opportunity to appear before you today. Mr. Kane and I will be happy to entertain any questions you may have.

Attachment: NASA launch schedule.

STS FLIGHT ASSIGNMENT BASELINE
13000-7

JULY 1982



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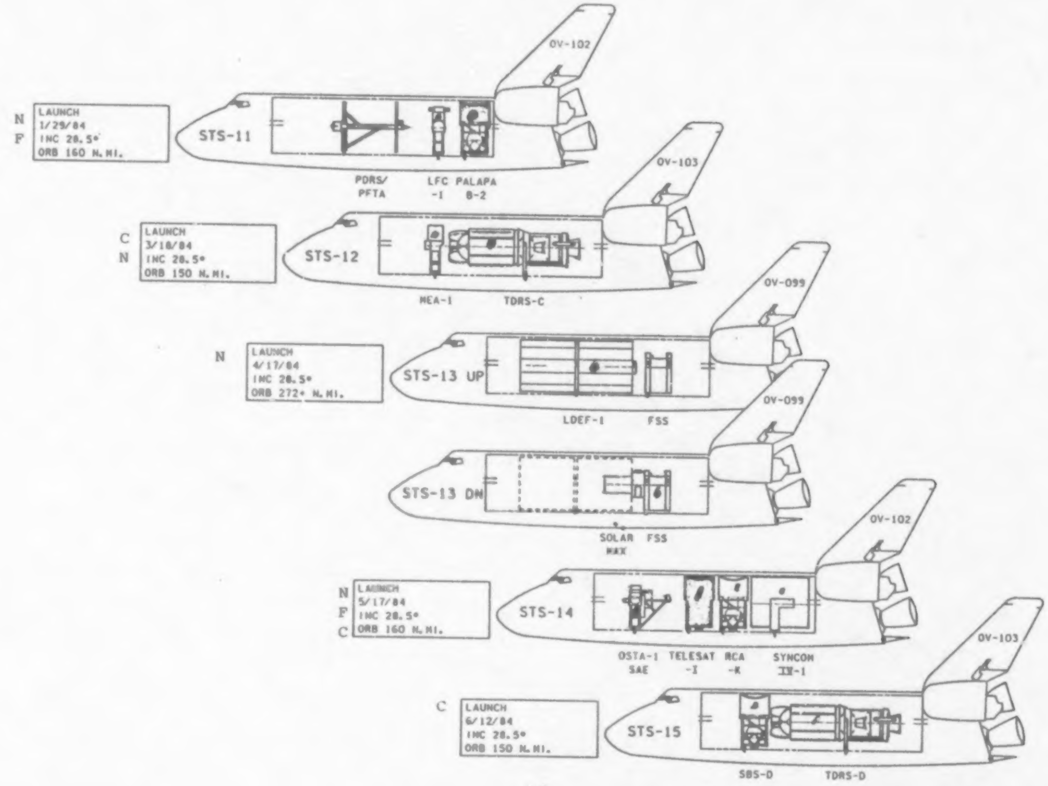

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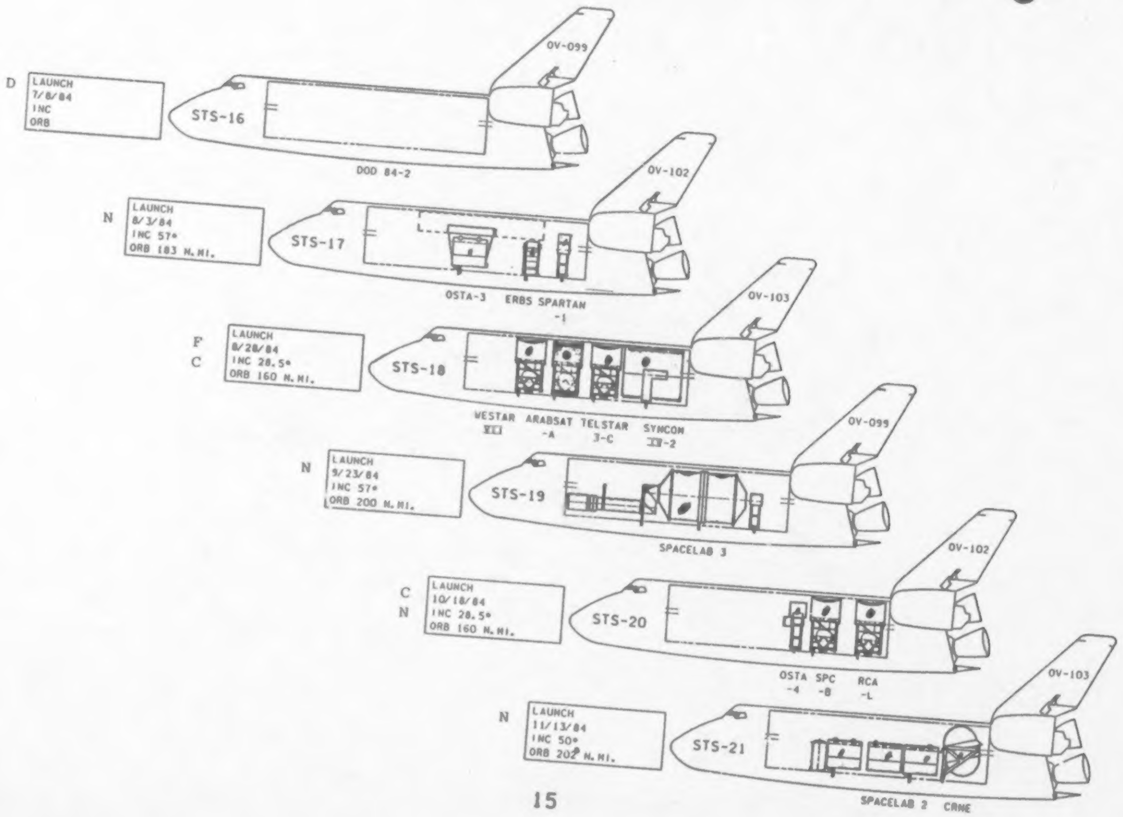

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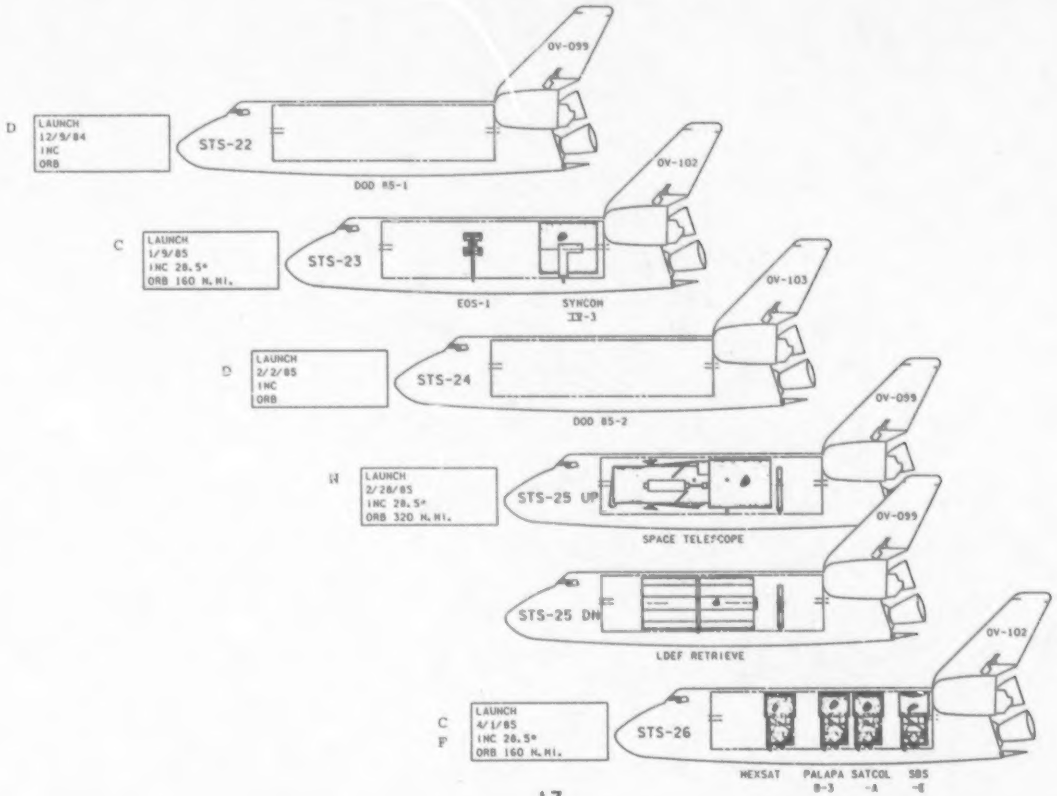

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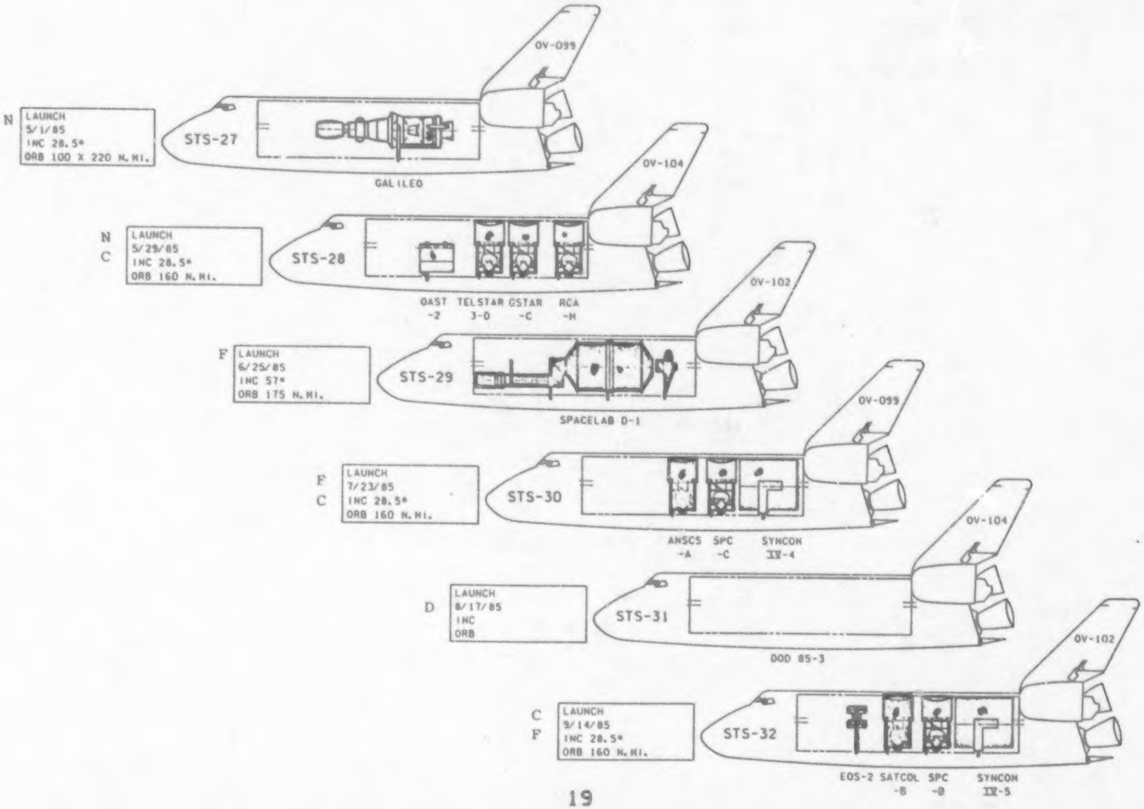

Senator GRASSLEY. Now, we have the last witness. Mr. Schwartz is a partner in the D.C. law firm of Crowell & Moring, and is also an adjunct professor at American University Law School. During the Carter and Ford administrations, Mr. Schwartz served as Chairman of the Department of Commerce Task Force on Product Liability and Accident Compensation, and as Director of a Federal Interagency Council on Insurance. He was one of the principal drafters of the Uniform Product Liability Act, and is a coauthor of casework materials on torts.

I am happy to welcome such an expert as you, and particularly welcome you with your experience in this area. I know that over a period of the last several years, you have worked very hard in this area. It is one that particularly small businesses in my State are very much interested in. So, I guess I could thank you for those people. I appreciate your contribution to that overall effort.

I suppose that you even find yourself working closely with Senator Kasten as he is working on this area right now, right?

Mr. SCHWARTZ. That is correct, Senator.

Senator GRASSLEY. Would you proceed, then, as you see fit? I am sorry. I did not introduce your——

STATEMENT OF VICTOR E. SCHWARTZ, CROWELL & MORING, WASHINGTON, D.C., ADJUNCT PROFESSOR, AMERICAN UNIVERSITY LAW SCHOOL, ACCOMPANIED BY FRED SOUK

Mr. SCHWARTZ. Mr. Fred Souk, an associate in our law firm, will be accompanying me.

Senator GRASSLEY. Well, welcome. Proceed then, please.

Mr. SCHWARTZ. Senator, thank you for the invitation to speak today. Back in 1978, you will recall you were kind enough to invite me out to Waterloo, Iowa, to speak to a group of small businessmen on product liability problems, and then we worked again together in 1980 when you were the principal speaker to the National Legal Center for the Public Interest on product liability problems. I know your interest in this does not start in 1982; that it goes back a long way, and that you are particularly interested in small businesses in Iowa who suffer problems not only in this area, but in other areas of product liability.

I am going to summarize my remarks because it is late in the day, and I have even heard a rumor that some people around here may want to go home soon. To quickly go to some of the most important points that have been made and maybe a few that have not, we have an unusual legal situation.

First, you have an ordinary case where the Government is at fault and has done something wrong and they have employed a Government contractor, and the fault is really with the Government and not with the contractor. If a citizen is injured and is hit by a mail truck that was manufactured by General Motors and is driven by the Government and it was at fault, if the citizen decides to sue General Motors, General Motors can bring a contribution claim against the Government for the fault that is the Government's.

It is a pretty simple procedure. It occurs in one trial and all the fault is allocated. The problem arises, however, when the injured party happens to be a Government employee. If he sues the Government contractor, the Government contractor has to bear total responsibility even if the Government has been substantially at fault. That is the reach of the *Stencel* decision.

This works against some fundamental principles of tort law, the most important of which is that the incentives for preventing a risk are supposed to be placed on the party who has done something wrong. Tort law is a goad and a prod to safety. Under the *Stencel* decision, tort law does not work its way because the Government never bears responsibility for what it does.

Another term that some professors use is that the Government is able to externalize the cost of a risk that it has created. This problem has been recognized since the *Stencel* case came down. I know of no other case that has received such universal approbrium from law school professors and people who have studied the law all over the country. People who favor plaintiffs and people who favor defendants, insurers—you name it—disagree with the decision.

Over time, the Justice Department is becoming a more lonely voice in its enamourement of that decision. When I was an official at the Commerce Department in 1978 and 1979, some propositions came forward to try to correct the decision. In the 96th Congress, H.R. 5351 was introduced. The Department of Commerce wrote a letter, which was approved by the OMB, which suggested that *Stencel* created a real problem and that legislation might be appropriate to correct it. The Department of Defense testified and said that the present system had unfairness. But no legislative solution worked its will.

In part, I think the business community is responsible that no legislative solution worked its will because we have not all tried to get together and really use whatever resources that we have to come up with a workable solution.

NAM has done that. In the NAM task force, there are insurers; there are insurance broker representatives, small business and large business. As a result, you have a combined effort to come up with a fair bill. Moreover, we have been able to look at past experience and prior bills and try to learn from them, with an effort to come up with something that is fair and workable and answers some of the Department of Justice's concerns.

In the past, the Justice Department has said that somehow this effort is going to change the rules whereby the Government is never strictly liable. That appears in Mr. McGrath's testimony. There are 3 or 4 pages devoted to the fact that the Government should never be strictly liable.

Well, in the proposition that was submitted to you by Mr. Brown, we are not asking for the Government to be deemed strictly liable. We are simply saying that when they are at fault, they should pay—no more, no less. We are simply saying that in the case where a Federal employee is injured by a product, it should be treated in the same way as when a non-Federal employee is injured. The rules would be the same and it would work the same in both cases—a procedure that has worked well in the courts without great cost.

You had suggested earlier—and I would be happy to expand on this if you want—as to whether what Senator Kasten is doing with the Uniform Product Liability Act really addresses this issue.

Senator **Grassley**. That was one of the questions I was going to ask you.

Mr. **Schwartz**. His bill, S. 2631, is directed at providing uniformity and stability in the current patchwork of product liability law. We have 51 different little sovereigns—really, more than that because the courts make the law—spewing forth new rules each day. S. 2631 would create one set of rules.

It is not directed in any way at changing the liability system between the Federal Government and its contractors. It in no way affects the Federal Tort Claims Act. Those are some of the reasons why it is before the Commerce Committee and not this subcommittee. S. 2631 addresses a problem that affects interstate commerce, without being directed at the Government contractor liability problem.

Senator Kasten used a staff draft approach, where he issued staff draft one, two, three, four, to get public comments. There was a provision in early staff drafts that incorporated the so-called Government contractor defense. In effect, the way this defense works is to say, "I am not responsible; the Government made me do it." And if you are able to prove that, you will not be liable at all.

Through the various staff drafts, this provision was dropped from the bill, in part because of the difficulty of drafting an all or nothing rule. I mean, under that defense, the Government contractor would not be liable at all. The thing that occurs most of the time is that there is fault on both sides when an accident has occurred. The Government may be partially responsible; the contractor may be partially responsible. That has never been addressed and will not be addressed by the Kasten bill. That can be addressed here.

The injured party sues the contractor. The contractor was partially responsible; he brings a contribution or indemnity claim against the Government, and its responsibility is allocated by the court and it pays its share. That has never been the approach taken in the Kasten bill and it is not a subject that is likely to be treated.

There is another part to this problem that has been alluded to, and that is the problem of catastrophic risk. It has been 10 years since a Federal task force first looked at this problem. That task force concluded that the problem should be addressed.

Every time we get a new administration, what happens is the wheel is rebuilt. The task force reports on this topic look a little like the city of Pompeii. They are just piled one on top of another. I think it takes action by a body that is in continuing session, with continuity, to look at all this stuff and come up with some practical solutions. You can look at what was done in the past and see what was good and bad.

For a number of years the idea was to draw some Maginot line about catastrophic risks, be it $500 million or $100 million; set that Maginot line and say that above that amount, you have got a catastrophic risk and below it you do not.

Well, this is anathema to change in the insurance industry. With respect to certain risks, they can write quite a bit and underwrite quite a bit of hazards. With respect to other risks, they cannot. Some things depend on the capacity of the insurance industry at a particular time. So, a flexible approach has been taken, leaving to the determination of individual agencies whether or not a particular risk is insurable or not.

Obviously, the incentive on the part of the Government is to say a risk is insurable and not accept indemnification. So, the proposal that Mr. Brown submitted to you really is not one where the Government contractors are going to come up feeding at the trough. All the incentives are to deny Government indemnification unless there is a showing that you simply cannot insure the risk. It is a simpler approach, more straightforward, and one that can be explained very quickly, and, thank the Lord, comprehensible to nonlawyers. Some of the old proposals were so complicated that when you talked about them to nonlawyers, their eyes would glaze over.

There are many other things that I have in my statement, but it is the end of the morning and I would value having your questions. Thank you.

Senator GRASSLEY. I had four questions and, as I suggested, you have addressed one of them already. These are three questions that I saved for you to respond to because of your unique expertise in this area.

How big of a problem is it in terms of dollars that Government contractors have to bear liability to Government employees when it is the Government that is at fault?

Mr. SCHWARTZ. I do not think that we can provide data on that. We have to go to ad hoc examples, such as the recent *Lockheed* case that we will submit a description of to the committee showing the amount of liability that would be extant in that case.

We would like to do at least a survey of some of the reported cases. The problem here, like the problems throughout product liability, is that much of the data is unavailable. The examples that you do surface, though, are multimillion dollar cases and suggest that it is a real problem.

The extent of the interest of people throughout the NAM suggests that it is a real problem. I assume they would not go forward with a large task force on an academic exercise. But we cannot give you a specific total dollar figure. We can give you examples of cases, and we will submit them to the committee, where the dollar figure is shown either in the amount of the judgment or the amount that is sought by the plaintiff.

Senator GRASSLEY. You addressed this next question just a little bit in how difficult it is to set a dollar point of catastrophe. Do you have any ideas as to how it should be determined at what level of liability Government indemnification should apply?

Mr. SCHWARTZ. Well, there are a number of factors. I think that judgments can be made about magnitudes of risk. Obviously, the magnitude of risk of a space shuttle falling down is different than a contract by the Government that is ordering pencils or those ubiquitously found Government pens.

There is a focus on the size of the businesses that might be involved in the particular bidding. If you are trying to encourage small businesses to bid on a particular contract, the level might be set differently than if we are dealing with larger businesses.

But probably the most important thing is what is reasonably available in the insurance market, and a determination of this can be made; brokers do it all the time. Actually, the Government does it today with respect to risks that are covered.

Unfortunately, in this area there is no litmus paper test. Anytime you set a fixed rule in cement, you are going to run into the problem that the insurance industry may well be able to cover that particular risk. We do not want a situation where the insurance industry is deprived of good and welcomed business opportunity. The point of this is to cover risks that simply cannot be insured and otherwise would go uncovered, and if a risk occurs, you would have the result of people who are injured and who have no real viable source of recovery and a contractor possibly out of business because of that risk.

Let me make one other point about that. Under all the systems, the contractor's liability would exist on its own up to a certain point. Its own insurance or self-insurance would cover it up to a certain point. Mr. McGrath earlier seemed to suggest that this would be a great heyday for the contractors; that they would all be immune from tort liability. Well, certainly, for the first multimillions of dollars, they would be subject to liability just like they are today and they would have very strong incentives to avoid that liability.

Senator Grassley. My last question deals with your assessment of what we might do, but it is in regard to a specific thought I have. Instead of trying to construct a new statutory scheme for indemnification, would it be sufficient to make adjustments in Public Law 85-804 so that it could be given broader application to situations not directly connected to the national defense and to situations where risks were not necessarily unusual hazards?

Mr. Schwartz. If you could deal with both of those problems, you would go a long way toward solving this problem. I do not believe that one could, by Executive order, expand coverages to matters that are not in the area of national defense. I think that at that point, some statutory change would be necessary. You also would not achieve the degree of uniformity of decision that you might achieve under comprehensive legislation.

But, certainly, the fact that a broader solution will take time should not preclude this committee from letting our friends in the executive branch know that it would be appropriate to expedite the reformulation of the Executive orders to the extent that can help.

The executive branch has had a report from an interagency task force sitting on desks with recommendations along that line since January. To the best of our knowledge, the report has been debated a lot, but it has been given too much attention.

So, I think that as a first step, changes in the Executive order can help a good deal, but they would not cover all the problems because of a need to amend certain legislation.

Mr. Souk. Senator, while amending the Executive orders and amending Public Law 85-804 would be a good step, one of the big problems is that it would still remain discretionary with the agency as to whether or not they would use the authority they had.

One of the problems that all of the contractors have faced in the past is that agencies have been reluctant, for whatever reason, many times unspoken reasons, to use authority that they already have. Contractors feel that while it would be a good step forward if the authority were expanded, if it is not going to be used, it will not do any good. And as long as the agencies can refuse to use their authority and not necessarily have any reason for doing so, the contractors are going to have a problem.

So, it would not be a comprehensive solution. It would certainly be a step in the right direction.

Senator **GRASSLEY**. That is the last question I have and, Professor Schwartz, you and your colleague conclude our witness list. I want to thank you as well as all of our other distinguished witnesses for their fine presentations.

[The prepared statement of Mr. Schwartz follows:]

PREPARED STATEMENT OF VICTOR E. SCHWARTZ

My name is Victor E. Schwartz. I am a partner in the Washington, D.C. law firm of Crowell & Moring, and I am also an adjunct professor at American University Law School.

In my years as a practicing lawyer and law professor, I have studied, written about, and worked on virtually every major issue concerning tort and liability insurance law, including the issues which are before this Committee today. During the administrations of President Ford and President Carter, I served as Chairman of the Department of Commerce Task Force on Product Liability and Accident Compensation and as Director of the Federal Interagency Council on Insurance. I was one of the principal drafters of the Uniform Product Liability Act, and I am the co-author of the casebook, Prosser, Wade & Schwartz, Cases and Materials on Torts.

For the past year, I have been working with a Task Force of the National Association of Manufacturers which has been seeking to develop solutions to the problems which are before this Subcommittee today. I appreciate the opportunity to appear here today and share with you my experiences and ideas regarding the important matters you are considering. The two major issues before you today are of great concern to the government contracting community, and they involve problems which have long called out for a solution. It is my belief that new legislation, carefully drafted to minimize cost and administrative burden, is the appropriate solution to these problems.

I. The Problem of Government Fault

I am sure it will come as no surprise to anyone on this Subcommittee that the United States Government is by far the largest purchaser of goods and services in the world. Government procurement involves every conceivable kind of product and service available in the private marketplace.

We would not be here today if all of the goods and services provided to the Government and the Government's procurement specifications and management of its goods and services after procurement were perfect. Unfortunately, however, neither the Government nor its suppliers function in a foolproof world. Accidents happen, and well-intentioned plans and projects sometimes do not turn out as expected.

When the goods and services procured by the Government cause harm to persons who are not Government employees, the present system can work equitably in regard to claims between the Government contractor who supplied the goods and services and the Government who specified and used the goods and services. If the injured person sues only the contractor and the contractor believes that the Government is partially or wholly at fault in causing the harm, the contractor can bring a third-party action against the Government under the Federal Tort Claims Act. The liability which the contractor ultimately has to pay to the injured person will be apportioned in the third-party action between the contractor and the Government generally on the basis of comparative fault principles.

On the other hand, when the injured person happens to be a Government employee -- either a civilian Government worker or a member of the military forces -- payment of liability to the injured person does not necessarily get apportioned on a fair basis. This is primarily because of court decisions -- the most famous of which is the Stencel case decided by the Supreme Court in 1977 -- in which the courts have determined that Congress intended the various federal worker compensation schemes to preclude suits by government contractors seeking to obtain contribution or indemnity from the Government for that portion of the contractor's liability to the Government employee caused by the Government's own negligence or wrongful conduct.

What frequently happens when a Government employee is injured due to products or services provided by private contractors is that the employee, who is precluded by the federal worker compensation statutes from suing the Government, brings suit against the contractor. If the contractor can be held liable -- either because the contractor has been at fault in causing the harm or because the doctrine of strict liability is applied to the contractor -- it ends up having to pay the total liability for the harm even though the Government may also have been at fault.

This situation is manifestly unfair to Government contractors, and it would not be difficult to understand the need for legislation to correct the situation if such unfairness were the only aspect of the problem. There is, however, a more subtle ramification of this unfortunate Government contractor liability situation. That is, the Government's ability to avoid liability for harm caused by its own fault flies in the face of one of the two basic policies which underlie all of tort law.

Obviously, one important policy of tort law is to compensate persons who suffer harm as a result of the misconduct of others. Tort law, however, has another equally important objective -- to create incentives for safe behavior. If this objective is to be fulfilled, financial responsibility for risks should be borne by those persons who have actual physical or administrative control of the risks. If it were otherwise, the person creating the risk would have no incentive to be as safe as possible in carrying out his activities.

What we have today in the situation where a government employee is injured by activities arising out of a Government contract is a flat violation of this second important principle of tort law. The Government is able to externalize -- i.e., push off on third parties -- responsibility for the risks associated with its own negligent conduct of activities. In such instances, the incentive for the Government to act safely and responsibly is lost.

The problem I am describing to you is one that has been recognized for some time now. There have been bills in this Congress and the previous Congress dealing with this subject. When I was at the Department of Commerce, we were asked to comment on the bill then before a Subcommittee of the House of Representatives (H.R. 5351). We recommended that a revised version of the bill was necessary and desirable. In making this recommendation, we arrived at an understanding with the Department of Defense that a bill to correct the Government fault problem was worthwhile. The Department of Defense subsequently appeared at the hearings concerning the bill and endorsed the purposes of the bill. See Hearing before the Subcommittee on Administrative Law and Governmental Relations of the Committee on the Judiciary on H.R. 5351 (July 21, 1980), at 39-42.

For the past year, a Task Force of the National Association of Manufacturers has been working with the House Subcommittee on Administrative Law and Governmental Relations to develop draft legislation which would provide an efficient but comprehensive solution to the problem we have been discussing. Mr. Brown, Chairman of the Task Force, has submitted to you with his statement a copy of the results of that effort.

The solution that is contained in the draft bill is simple and straightforward. Using the same procedures and legal principles which are presently employed under the Federal Tort Claims Act when persons who are not Government employees are injured by contractor-supplied goods or services, this draft bill would allow Government contractors to obtain contribution from the Government toward payment of liability to Government employees in proportion to the Government's fault in causing that liability.

For example, if the Government drafted defective specifications for a product or service, and if the contractor had brought the defect in the specifications to the Government's attention and the Government had nevertheless insisted that the contractor proceed in accordance with the defective specifications, the Government would become totally responsible for any liability to third persons which ensued. On the other hand, where a contractor drafts the specifications for the product or service to be supplied to the Government, and where the Government neither knew of nor should have discovered the defect, the contractor would become totally responsible for the liability which ensues. In other types of cases where the both the Government and the contractor are at fault in allowing the harm to occur -- for example, where the contractor produces a defective product not in conformity with the specifications, but the Government fails to properly inspect the product or exacerbates the defect through negligent maintenance -- both the contractor and the Government would share the liability in proportion to their respective faults as determined by the courts.

This is a fair system, it is a sensible and workable system, and it is a system which will minimize legal and administrative costs of the Government. The system has been shaped to resolve many of the criticisms which the Department of Justice and other agencies raised about prior bills. I urge that this Subcommittee give consideration to adopting this system in seeking to correct the existing inequity in the law.

Before I leave the subject of this particular problem, I think it is important for me to provide you some information with regard to the relationship of this problem to the Senate bill (S. 2631) to establish a uniform federal product liability law which is currently being considered by the Senate Commerce Committee.

S. 2631 is directed at providing uniformity and stability in the current patchwork system of product liability law. It is not directed at changing the liability system as between the Federal Government and its contractors. It does not in any way amend the Federal Tort Claims Act. In sum, the bill is directed at solving a problem of interstate and foreign commerce, not potential inequities under the Federal Tort Claims Act.

Early drafts of S. 2631 contained a provision which would incorporate a version of the so-called Government contractor defense. The elements of the Government contractor defense, as recently set forth by one court, are as follows: (1) the Government established the specifications for the product or service which it procured, (2) the contractor fully complied with the specifications, and (3) the Government knew as much as or more than the contractor about potential hazards of the product or service. If these elements are satisfied, the contractor will have an absolute defense to tort suits brought against it by third persons. The provision for such a defense in the early drafts of S. 2631 was subsequently deleted.

Whether or not a Government contractor defense were to be provided by a federal product liability bill, the problem of Government responsibility for liability caused by its own fault would not be solved. While such a defense would restore fairness in the situation where the Government is completely at fault and the contractor is completely blameless, the defense would not resolve situations where both parties are at fault. Moreover, as the defense is now developing in the case law, it seems clear that it will not be applied to many of the situations which arise in Government contracting.

Thus, legislation along the lines of the draft bill submitted by Mr. Brown remains the only comprehensive solution to the problem of Government avoidance of responsibility for liability caused by its own fault.

II. The Problem of Catastrophic Liability

The second problem with which this Subcommittee is grappling today is related to the first, but involves different policy considerations. It is the problem of catastrophic liability which can arise from the performance of Government contracts. The essence of the problem is that the amount of liability that can result from the occurrence of risk associated with certain types of contracts can be so great that the contractor involved, no matter what its size and financial strength may be, will become insolvent upon the occurrence of the risk.

Fortunately, there have been few occurrences of catastrophic liability in the history of Government procurement. Nevertheless, the potential for such liability is real and of great concern to all Government contractors, be they large corporations or small family-owned businesses. Many of the types of Government procurement activities involving potentially catastrophic risks are well-known -- for example, military equipment supply programs (such as missiles, bombs, ships, and planes), medical research, air traffic control, space exploration, and public works projects (such as dams). Other examples of potentially catastrophic loss stem from the provision to the Government of goods and services, now thought to be perfectly harmless, which may at some future point be found to have in fact caused tremendous harm. For example, clothing supplied for military uniforms may be produced using various chemicals to augment certain characteristics such as impermeability or fire resistance. Conceivably, twenty years from now, some of the chemicals contained in these uniforms could be found to have caused cancer or other serious diseases in thousands of military personnel who wore the uniforms over the years.

It goes without question that every responsible business, including every Government contractor, will maintain the maximum level of liability insurance it can afford or obtain in order to protect against claims that will arise from its products and services. The catastrophic liability problem occurs, however, because for the examples discussed above and many others, no company can afford a level of insurance which would be sufficient to insure against the amount of liability that can ensue from the type of risk involved.

This problem involves two extremely important public policy considerations. First, it is essential for the Government to be able to procure the variety of goods and services necessary for the proper functioning of the Government. To the extent possible, these goods and services should be of the highest possible quality for the lowest feasible cost. This, in turn, requires that participation in bidding for Government contracts be maximized. To the extent that companies determine that it would be unwise and unworkable for them to bid on government contracts because of the potential for catastrophic liability, the important goal of maximizing competition will be unattainable. Indeed, if a sufficient number of responsible potential contractors determine not to participate in the contracting process due to the catastrophic risk problem, the government can end up in a situation where either (1) it cannot obtain the goods or services it desires, or (2) it can obtain goods and services, but at the risk that they will be supplied by less responsible companies who will not only provide a lower quality product or service but will also increase the risk of catastrophic liability through less attention to safety.

Second, when catastrophic liability does occur, the persons who suffer the harm from the catastrophic occurrence should be compensated in a fair and efficient manner. If the Government is at fault, the injured persons can generally receive appropriate compensation either under the Federal Tort Claims Act or by way of Federal worker compensation. If the contractor is at fault or if the contractor would normally be liable under principles of strict liability, injured persons can receive appropriate compensation unless the contractor cannot remain solvent in the face of an inordinate level of claims. If the contractor becomes insolvent, the burden of the catastrophe will be borne initially by the innocent victims and thereafter by the public at large through the reduced productivity of the victims, the public benefits which have to be provided to the victims, and the disruption of businesses and personal lives.

The problem of catastrophic liability has long been recognized. On two occasions, Congress has enacted special legislation in order to enable the Government to get any contractors at all to perform highly beneficial but potentially extremely risky tasks -- i.e., the Price-Anderson Act which provides for limitation of liability and indemnification for contractors constructing nuclear reactors, and the legislation which provides total indemnification by the Government for contractors which supplied the vaccine for the swine flu immunization program in 1976.

Congress has also enacted certain other limited indemnification laws designed to insure appropriate participation of industry in the Government procurement process while at the same time protecting potential victims of catastrophes. The most prominent of these is Public Law 85-804 which is implemented by two executive orders. Unfortunately, this law is limited to contracts connected with the national defense. A further limitation is that the risk for which indemnification is to be provided must be identified in the contract as being either "unusually hazardous" or "nuclear" in nature. While some activities connected with the national defense can easily be characterized by the agencies supervising them as "unusually hazardous," many agencies are reluctant to characterize their activities in such a fashion. Finally, it should be noted that the indemnification provided pursuant to Public Law 85-804 and its implementing executive orders is not automatic. For reasons completely unrelated to the need for indemnification, a contracting agency can decide that it will refuse to enter into an indemnification agreement as part of the Government contract. A similiar indemnification statute with similar drawbacks is contained at 10 U.S.C. § 2354, which allows contractual indemnification against "unusually hazardous" risks identified in military research and development contracts.

Taken as a whole, the existing indemnification statutes are a hodge-podge which fall far short of a comprehensive solution to the catastrophic liability problems of government contractors. The Commission on Government Procurement, in its 1972 Report, specifically found that these existing statutes were inadequate and recommended that they be replaced with a more comprehensive piece of new legislation. To date, the recommendation of that Commission has not been carried out, even though there has been a continuing recognition by various agencies of the Government of the seriousness of the problem.

Since 1972, two separate Government interagency task forces have worked on trying to come up with a consensus solution to the catastrophic liability problem. The most recent of these task forces conducted a survey of various Government agencies and determined that indemnification against catastrophic liability remains a very real problem and one which requires a solution. In a report issued in January of this year, that task force, with a lone dissent by the Department of Justice, recommended that the executive orders implementing Public Law 85-804 be broadened so as to allow their implementation whenever catastrophic loss could be encountered (not just when "unusually hazardous" or "nuclear" risks are involved). The Task Force expressed the view that with such broadening of the executive orders, and with a liberal interpretation as to which activities are connected with the national defense, much of the problem could be resolved. However, the Task Force report has not been implemented, and its status is uncertain at this point.

There is no question that revision of the executive orders implementing Public Law 85-804 so as to broaden their application would be meritorious. However, certain problems would remain. No matter now broad the notion of national defense is interpreted to be, there will be a number of Government procurement activities which fall outside the concept. As long as indemnification remains discretionary with contracting agencies, the catastrophic liability problem will not go away because the agencies will be able to avoid providing such indemnity.

In light of these circumstances, the most sensible approach to the catastrophic liability problem is a new law which provides an omnibus solution. Such a law must have sufficient flexibility to accommodate the indemnification needs involved in the total spectrum of Government procurement. The law must also accommodate, to the extent possible, the interests of the various parties affected by it. The needs of those who will become claimants as a result of a catastrophic occurrence must, of course, be met. The private insurance industry must not be penalized, and the use of private insurance should be fostered to the extent feasible. The differences between the liability-bearing capabilities of small businesses and large businesses must be accommodated. Such a law must protect the Government from inappropriate expenditure of funds. Finally, the new law must not put the Government in the position of encouraging irresponsible safety practices by its contractors.

Let me be the first to admit that the drafting of such legislation is no easy matter. Mr. Brown has provided to you with his statement a copy of draft legislation which I believe is the right approach to the problem. It is not necessarily the only workable approach, but it is an approach that I believe may accommodate the various interests I have described.

In light of the complexity and difficulties inherent in this problem, it would be easy for Congress to do what the Executive Branch has been doing -- procrastinate and hope that unindemnified catastrophic liability does not occur. I urge you not to do this. This is a problem which will only get worse as Government procurement involves more and more sophisticated and exotic goods and services. If the problem is not solved, the ultimate effects will be extremely harmful. The Government will find itself unable to get certain beneficial but highly risky tasks accomplished. If a catastrophe occurs, the response will be more inefficient, time-consuming, and expensive than if legislation is already in place.

I believe I speak for all of the representatives of the contractor community appearing before you today in saying that we are prepared to expend whatever effort is required to assist you in developing a legislative solution to the problems I have described. We encourage a thorough exploration of all alternatives for a solution, and we urge any other parties who may have proposals to come forward and present their views. With all interested parties working in good faith together, I believe that a solution to the problems surrounding government contractor liability can at last be brought to fruition.

Senator **Grassley**. I believe that the record that we have established here today is going to be a valuable contribution to solving the problems that we have before us and to resolving some of the questions inherent in Government-supplier relationships.

I am going to have a second hearing on this topic either in late November or early December. Of course, all of that depends upon how that works into what we believe to be a reality now—a lame duck session. I am going to wait until the conclusion of the second hearing before having the record printed up so that we might have one volume to refer to instead of two volumes.

Again, I thank all of you for your attendance. The hearing is adjourned.

[Whereupon, at 12:05 p.m., the subcommittee was adjourned.]

INDEMNIFICATION OF GOVERNMENT CONTRACTORS

THURSDAY, DECEMBER 2, 1982

U.S. SENATE,
SUBCOMMITTEE ON AGENCY ADMINISTRATION,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The subcommittee met, pursuant to notice, at 11:03 a.m., in room 2228, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the subcommittee) presiding.

Staff present: John Maxwell, chief counsel and staff director; Lynda Nersesian, counsel; and Susan Shirk, office manager.

OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. This hearing of the Senate Judiciary Committee will come to order.

The reason that we are starting 1 hour late is the fact that the Senate Republican Caucus was meeting to select our leadership. That is a biennial process that we go through. We adjourned at 10:53, so I came here just as soon as I could, and I hope that you will forgive us for starting late.

We had anticipated that it would only take one hour. Most of the process was done by about 10:15, but then we went through a discussion of whether or not any rules ought to be changed in regard to seniority on the specific committees vis-a-vis freshman members of the caucus, and that discussion took a long time. As you know, the seniority system in the U.S. Senate is something that is very dear to our hearts, particularly the longer we are here. As a result of that, I felt compelled to stay there and hear all that discussion, so, again, I hope you will forgive me.

I have a short statement that I want to go through, mostly because we started hearings on this general subject more than 60 days ago and I think it is necessary for all of us to see the context in which we are here.

We are here to continue consideration of the Federal Government's tort liability in the context of an indemnity or contribution action. This is the second oversight hearing that the Subcommittee on Agency Administration has conducted on the practicability of indemnifying government contractors. It is likely that due to the level of interest of these hearings, a third oversight hearing will be scheduled for January.

Providing for a policy of contribution or indemnification of government contractors in appropriate circumstances necessarily affects a variety of interests. We must take into account the interests of the Government, the contractors, insurers, potential victims, claimants and, most importantly, the interests of the public and the taxpayers.

The record formed from the September 30 hearing and the written testimony submitted for today's hearing suggest that two of the articulated interests—that of the Government and that of the contractor—are very different. The Department of Justice is on record as opposing any legislation to expand the liability of the United States.

The Department testified that Government contracts are still actively pursued. Assistant Attorney General McGrath stated, "the fact that considerable visible effort goes into the competitive battle to secure an edge in receiving Government business speaks eloquently against the argument that the expansion of indemnification is necessary."

LIABILITY HINDRANCE TO COMPETITIVE BIDDING

From a different perspective, Richard Brown, chairman of the Task Force on Indemnification of Government Contractors for the National Association of Manufacturers, referred to the increasingly onerous exposure to liability. According to Mr. Brown, this liability will discourage existing contractors from undertaking essential programs and will deter other prospective contractors, particularly small contractors, from competing for Government work.

Expanding on this analysis, Professor Tobak, whom we will be hearing from today, submits in his written testimony that the present liability consequences facing Government contractors may serve to frighten off the responsible contractor. According to Mr. Tobak, through its indemnification policy the Government is potentially limiting the available pool of competitors, making it more likely that a successful bidder is one who disregards the liability potential. This is not a very attractive recourse for harmed claimants.

Another ramification of the contractor's liability that was articulated at our prior hearing has to do with the availability of insurance to cover some of the more risky ventures in which the Government is involved.

Eaton Corp. cited its potential exposure of $350 million in the event of an aborted commercial space flight. The only insurance that Eaton has been able to secure is from a combination of companies willing to undertake only $50 million worth of coverage. The premium on this insurance is $10 million per year, with a $5 million deductible. According to Eaton, this is the only combination of insurers which surfaced to undertake any portion of the liability. This causes those of us in the Congress ample concern.

I am very pleased that we have such a range of interests represented by our distinguished witnesses today. We will hear from the Department of Defense as well as from a large manufacturer and Government contractor, Dow Chemical, that has been involved in litigation for a number of years stemming from its contractors role. We will also hear from a smaller, high-technology company and Government supplier out of my favorite, home State of Iowa; from

Professor Tobak, who has written a very fine piece on the current state of the law; and from the American Bar Association, an association that we all respect very much.

We welcome our first witness, Mr. William A. Long, who is Deputy Under Secretary of Defense for Research and Engineering. I understand that you have been in the position for 2 years, Mr. Long, and I would ask you to come forward and proceed.

I would like to announce for the benefit of all—and I suppose it is even more urgent considering the fact that I started the meeting 1 hour and 3 minutes late—that we keep to the schedule of about 10 minutes per witness, because I do have some questions that I want to exchange with the witnesses.

I would like to suggest that for long statements, as is our normal procedure, that they be printed in the record, and that you summarize.

I would like to have you proceed, Mr. Long.

STATEMENT OF WILLIAM A. LONG, DEPUTY UNDER SECRETARY OF DEFENSE FOR ACQUISITION MANAGEMENT, ACCOMPANIED BY JOHN KENDIG, DIRECTOR, COST, PRICING AND FINANCE, U.S. DEPARTMENT OF DEFENSE

Mr. LONG. It is a pleasure to be here, Mr. Chairman. I must ask you, when you talk about long statements, you are referring to the number of pages and not my name?

Senator GRASSLEY. That is very true.

Mr. LONG. I do have a relatively short statement that I think speaks for itself. There are two instances in which the Department of Defense feels that the issue needs to be examined. One is the hazardous or nuclear-risk type of area. The second is the area of extremely high liability or catastrophic loss. We think that these two areas merit some further consideration.

I have in the statement some cautions that I do not think I need to repeat here. But I would like to take a minute and explain why the Department of Defense has an interest in this issue.

We are buyers, and it is from this circumstance that our interest really evolves. And I think it is important to recognize, in looking at this and any other issue that potentially affects either price or industrial base, that those are the two points where this particular issue can impact the Department of Defense.

I would suggest that in a free economy such as ours, there really is no free lunch, and ultimately, in a macrosense, the Department of Defense is going to pay the price. The question is what is the most cost-effective way to pay that price? Is it through insurance premiums that are allowable costs?

As you alluded to the Eaton circumstance, there may be some instances in which insurance is not available at any cost from a carrier, and therefore the company, again, in a macrosense, is going to include the risk element in its price, and that is going to drive the prices up.

So I think we are looking at it from a cost-effective standpoint; also, from an industrial base standpoint. If there is a circumstance in which the industrial community is going to either go out of business in the case of a catastrophic loss to a particular company, or go out of the defense business, just finding the circumstances of doing business with the Department too risky, then we have great concerns.

As we look at the present state of the law and our authorities, we think we have sufficient authority to cover some circumstances that fall within the class that I have alluded to. We do have some enabling legislation in the Armed Services Procurement Act. There is some enabling legislation under the so-called Public Law 85-804, as supplemented by an Executive order. And we think we can deal with some of these circumstances.

But, quite frankly, we are not bright enough to foretell all of the circumstances that may arise in the future, and we think it may be the time to take a look at the existing legislation and see if we need to provide authority for additional coverage under circumstances as they appear in a contractual sense or a negotiation sense in the future. We are just not sure that everything that ought to be covered is covered.

With that, Mr. Chairman, I would be pleased to answer any questions you may have.

Senator GRASSLEY. Well, I thank you and I know that your statement is as comprehensive as you said it is, and it is going to be very valuable to us as we look further into this problem, hoping to find a solution for it. And we know that your Department, firsthand, knows the problems, and I think, you know, bringing home the reality that there is no free lunch, as you said, and trying to bring out all the facts—and there is cost to the existing situation—is an important aspect, and we appreciate your contribution to that.

I have some questions I want to ask you. There exist some statutes which provide for indemnification in what is referred to as unusually hazardous risk, these situations arising out of either military research or development contracts or contracts furthering the national defense.

What figures into the Department's definition of "unusually hazardous"?

Mr. LONG. Well, we look at that—first of all, let me say I may need to supplement this for the record, but from a general standpoint we look at the facts and circumstances surrounding a particular contract action. This is not a determination made on a class basis, generally. We will make it either with respect to contracts or programs.

One looks to a variety of circumstances and the availability of insurance or non-availability of insurance may be a very large factor in determining whether a risk is unusually hazardous, and also the price of private insurance.

There are other facts and circumstances that I am sure we look at, but I will have to dig out the history of our utilization, particularly of 85-804, and supplement for the record the specific criteria that we look at.

[Subsequent to the hearing, the subcommittee received the following information:]

Items that fit into the definition of "unusually hazardous" are generally those associated with nuclear-powered vessels, nuclear-armed guided missiles, experimental work with nuclear energy, handling of explosives, or performance in hazardous areas. In addition, indemnification clauses are inserted into all transportation contracts entered into by the Military Airlift Command for transportation services to be performed by air carriers that own or control aircraft which have been allocated by the Department of Transportation to the Civil Reserve Air Fleet. Indemnification clauses inserted into transportation contracts are authorized by Public Law 95-163.

Senator GRASSLEY. Do you have any quantitative judgments you can make, like the percentage of cases that this definition has applied to?

Mr. LONG. It is very, very small, but I cannot give you a precise number. I am sure it is less than one percent of our contracts.

Senator GRASSLEY. Well, what about any examples? Do you have any examples, or could you supply us with some examples?

Mr. LONG. We will go back through the history of 85-804, which is over, say, the last 5 years, and give you all the circumstances in which we have used it, and also the R&D one, title 10, United States Code, section 2354.

[Subsequent to the hearing, the subcommittee received the following information:]

Provisions to indemnify contractors against liabilities because of death or injury or property damage arising out of nuclear radiation, use of high energy propellants, or other risks not covered by the contractor's insurance program were included in 75 contracts during calendar year 1978, 127 during 1979 and 66 during 1980. Compared to the total number of contracts awarded by the department in those years, the percentage of cases was very small, much less than one percent.

Senator GRASSLEY. Could you elaborate on a recent Comptroller General ruling that casts doubts on the legality of obligating Government funds for undetermined future liability?

Mr. LONG. I have a copy here of that Comptroller General's determination.

Senator GRASSLEY. The one I am referring to is from May 3, 1982.

Mr. LONG. Our general counsel is examining this issue right now. If you will recall from that case, it involved a Federal procurement regulation as implemented by the Department of Health and Human Services. We have a similar regulation in the defense acquisition regulations.

You will also note that the Comptroller General alludes to its position that if there is no enabling or no other specific legislation, then it brings into question the appropriateness of the use of this regulation to cover a contingent liability in a nonobligated fund sense.

What our lawyers are looking at is whether the two statutes that I alluded to earlier, 85-804 or title 10 United States Code, whatever the number is, provide that statutory basis to permit us, in the unusually hazardous risk area, to do what we have done on occasion in the past. We do not have an opinion yet from our general counsel.

Senator GRASSLEY. Did the Department of Defense direct Dow Chemical, who has a person testifying here today, to manufacture agent orange?

Mr. LONG. I have no information on that, Mr. Chairman.

Senator **Grassley**. Does the Government have the in-house capacity to design and control the manufacture of sophisticated products and services?

Mr. **Long**. Well, the development of our specification for our weapons systems and communications systems and the like is a process that cannot be categorized as uniquely within the power of the Government or uniquely within the power of the contracting community.

I think if you look at the spectrum of the things that we buy, you will find many instances in which we send out very detailed specifications and say, "Here is what you are to build; go build it." We have other circumstances in which the evolution of the specifications is a joint, cooperative effort. And we have other circumstances where the request out to the contractor community is purely functional saying, "We want something that will do this; now you build it in whatever way you want." So there is no one answer to your question.

Senator **Grassley**. Will the Government indemnify where we have asked the contractor to take on a certain responsibility?

Mr. **Long**. As a matter of course, no.

Senator **Grassley**. Is that fair?

Mr. **Long**. Well, I guess the question of whether it is fair or not depends upon—I go back to my earlier remarks—depends upon whether there is insurance against risk available at a reasonable price.

I think, really, we are talking about the price and what is the most cost-effective way to cover the risks. You know, people tend to forget that the contracting community is very sophisticated in terms of pricing. We buy warranties against defective workmanship and defective material all the time. But that is not free; that is cranked into the price. The contracting community will have its own data base on what the fulfillment of the warranty obligations are likely to cost it, and we pay for that.

So it really is not an issue of fairness if there can be coverage obtained from some source at a reasonable price, and I think that is really the issue.

Senator **Grassley**. That gets back to the subject of the fairness to the taxpayers and the cost effectiveness. Is that the way that it is looked on? If it is available, that is the most cost-effective way to do it?

Mr. **Long**. I am not suggesting for a moment that just because insurance is available at some price, that is the most cost-effective way to do it. I think that is one of the very tough issues that this committee and the various departments have to look at, because I know, just instinctively without having any data to support it, that there are circumstances where insurance company coverage is not going to be cost effective.

Maybe the Eaton circumstance is a very good example of that. I only mention that because you mentioned it in your statement. I am not suggesting that that be the case, but there are times when private insurance from private carriers is cost effective and times when it is not.

Senator **Grassley**. Do you have any figures as to the number of successful claims brought by Government contractors under the Federal Tort Claims Act?

Mr. **Long**. I can provide that data, Mr. Chairman, I do not have it here.

[Subsequent to the hearing, the subcommittee received the following information:]

To date, there is no record of successful claims brought by Government contractors under the Federal Tort Claims Act.

Senator **Grassley**. We would also be interested in the same question as it applied to the military sector.

Mr. **Long**. To date, there is no record of successful claims brought by Government personnel under the Federal Tort Claims Act.

I am not sure it applies to the military sector under the Tort Claims Act; I am just not sure that military personnel have rights under the Federal Tort Claims Act.

Senator **Grassley**. Well, you know, we are aware of the Feres doctrine, but within the limits of that.

Mr. **Long**. Sure.

Senator **Grassley**. Those are the only questions that I have orally to give to you, but we will probably have some questions in writing.

Mr. **Long**. That will be fine. May I make just one additional statement?

Senator **Grassley**. Yes, you can.

Mr. **Long**. It is in the statement, but I do want the committee to know that the executive branch is undertaking a review of the entire circumstances that this committee is also involved in, and that may be something which you are unaware of. But in our dialog with OMB leading up to this hearing, OMB is going to undertake a review within the executive branch as well. Now, that is in the statement, but I just wanted to highlight that.

Senator **Grassley**. Well, we thank you for that information. At least I was not aware of it; I do not know whether my staff was or not.

Mr. **Long**. Well, I was not until very recently.

Senator **Grassley**. We do appreciate that information. I am sorry that I did not ask you to introduce your colleague with you.

Mr. **Long**. And I apologize for not. This is John Kendig, who is the Director of cost, pricing, and finance in the Office of the Under Secretary, and I apologize for not introducing him.

Senator **Grassley**. We thank you for your availability for answering questions and participating in this. I thank you very much, Mr. Long, for participating.

[The prepared statement of Mr. Long follows:]

PREPARED STATEMENT OF WILLIAM A. LONG

Good morning Mr. Chairman and members of the subcommittee. We appreciate the opportunity to appear before you today and to present the views of the Department of Defense, concerning the practicability of providing a scheme for indemnification of Government contractors in appropriate circumstances.

We believe there are two basic sets of circumstances that should be discussed. First, those cases that involve unusually hazardous or nuclear risks. Second, all other cases for which there is a potential for an extremely high liability loss, but for which insurance cannot be obtained at a reasonable cost.

In connection with situations involving unusually hazardous or nuclear risks, the Department of Defense already has the ability to indemnify contractors. 10 U.S.C. 2354 which concerns military research and development contracts and Public Law 85-804 which is implemented by Executive Order 10789, permit the indemnification of contractors, under appropriate circumstances. The use of these authorities within DOD has been narrowly defined and is strictly monitored. These laws have served us well over the past 25 years. Therefore, we do not believe that any congressional action is necessary in connection with these circumstances, and we would recommend against any expansion of these laws.

In connection with other circumstances not covered by 10 U.S.C. 2354 and Public Law 85-804 where there is nevertheless a possibility for an extremely high liability loss, but for which insurance cannot be obtained at a reasonable cost, we agree that there may be a need to provide some very limited scheme of indemnification within present law. However, we believe that the Government's liability in these circumstances would have to be narrowly defined. The Government should not be placed in a position of a general insurer. This matter is currently under review within the administration.

Most of the legislation considered over the past few years has been so broadly written that it would have made the Government an indemnifier for all contracts for products or services, including products designed in conjunction with the contractors and for the purchase of commercial, off-the-shelf items. In addition, those proposed bills would have made the Government an indemnifier in connection with suits by Government civilian and military employees based on injuries that arose out of their service to the Government. Further, the bills would have required the United States to indemnify suppliers to foreign governments where the foreign government, and not the United States Government, is responsible for the harm creating the supplier's liability.

In our opinion, the Government should become an indemnifier only in exceptional circumstances, such as those covered by Public Law 85-804. To do otherwise could result in contractors failing to exercise their responsibility to produce defect-free products and subject the Government to an unlimited number of liability claims.

With respect to indemnification in connection with Government civilian and military employees, we believe this would be most inappropriate. Congress already has established compensation plans for employment related injuries or disabilities. Thus, in our opinion further compensation from the Government is not necessary. In addition, we believe that the right to sue the Government through the contractors could lead to adverse morale and discipline problems, because it would establish an adversary relationship between the employees and the Government.

Finally, in connection with the indemnifying suppliers to foreign governments, we believe it would be absolutely essential to avoid transferring the responsibilities of those governments to the United States Government.

That concludes my prepared statement. I would be happy to answer any questions that the members of the subcommittee may have.

Senator **Grassley**. I want to take our next witness out of order for the reason of health, I understand. Mr. Tobak is under the weather and since he is so valuable to our testimony, we would like to have him come forward.

Please be seated. Thank you very much for coming. I would like to explain to everybody that you are professor of law at Lehigh University. He received his degree from Stanford University. His article entitled "A Case of Mistaken Liability: The Government Contractor Liability for Injuries Incurred by Members of the Armed Forces," is a very worthwhile analysis for the purposes of this hearing.

We welcome you, Professor, and hope that the constraints of your illness do not make you feel too uncomfortable, but we appreciate your coming. I would like to have you proceed with your statement within the confines of my previous admonition, and then I have some questions that I want to ask you as well.

STATEMENT OF JAMES W. TOBAK, PROFESSOR OF LAW, COLLEGE OF BUSINESS AND ECONOMICS, LEHIGH UNIVERSITY

Mr. TOBAK. Thank you, Mr. Chairman, and thank you, staff. I will not get too close to the microphone; I do not want to contaminate anybody else with this virus.

My name is Jim Tobak and, as you said, I am a professor of law at Lehigh University. I am pleased to have this opportunity to appear before you today to express my views regarding the practicability of providing for a scheme of contribution or indemnification of Government contractors in appropriate circumstances.

The convergence, a sort of melange of three distinct fields of law—sovereign immunity, strict product liability, and Government contracting—has created unusual and inequitable liability exposure for the Government contractor. Contracted to supply a product according to Government specifications, possibly even using materials provided by the Government, the contractor can comply completely with the specifications and still be held solely liable for injuries suffered by civilian or military personnel who are injured by the product incident to their employment or service. This is the case even where the defect in the product that caused the injury is directly attributable to Government error in the design or specifications.

The liability vise that squeezes the contractor between strict product liability, the exigencies of contracting with the Government and sovereign immunity was transformed into a liability noose by the Supreme Court's famous decision in *Stencel Aero.*

GOVERNMENT IMMUNITY EXTENDED

As I believe you are aware, the Supreme Court in *Stencel* extended the Government's sovereign immunity to third-party indemnification or contribution actions. Government contractors are now not only subject to direct liability for defective products—defects that may be caused by governmental wrongdoing—but also have no recourse against the Government for indemnification or contribution.

Although this glaring inequity causes me concern, I am far more troubled by the distinct possibility that under current law, the dangers that Federal civilian and military personnel face from defective products may be increased rather than decreased.

If one puts any credence in the traditional tort notion that financial accountability is a critical incentive that encourages people to exercise more rather than less care, skill and caution in the conduct of their activities, then insulating the Government from liability is counterproductive logic.

Insofar as the current laws create an asymmetry or imbalance in exposure to liability, this critical incentive is undercut. The *Stencel Aero* case and the agent orange product liability action furnish good examples of how insulating the Government from product liability may have this pernicious tendency to increase rather than reduce the probability of injury.

One has to wonder if the institutional and policy pressures that cause Government agents to push ahead with contract performance or to use a product in a particular way might well be counterbalanced by a financial accountability that accurately reflects irresponsible or careless actions.

Although there are other problems created by the current law, I see this as potentially the most serious. Existing legal and practical options provide a patchwork solution that neither sufficiently protects contractors nor adequately responds to the problems created by the current distorted liability system, particularly that of risk minimization.

The problems engendered by the current laws could be rectified by comprehensive, carefully drafted legislation. The uppermost objective must be the minimization of risk and injury and the concomitant reduction of the sum total of liability.

To achieve this end, legislation that links liability to fault through a systematic scheme of Government indemnification or contribution is crucial. Such comparative fault legislation would relieve the contractor of unfair liability exposure for Government wrongdoing, and would hopefully increase the incentive for Government agents to act reasonably and carefully.

I have reviewed the National Association of Manufacturers' draft bill, which I believe has been presented to you. I find the draft bill—specifically, section 5 on Government contribution to suppliers—to be a levelheaded, workable legislative solution. In particular, the comparative fault feature of the draft bill is appropriate insofar as it reintroduces fault as the linchpin for liability.

The current liability cul de sac is all too easy to offhandedly dismiss. The Government appears to be a winner, whereas the Government contractors—a group not likely to garner a great deal of public sympathy—appear to be the only losers. This unfortunate perception glosses over the serious problems and distortions created by the current system.

The Government is ensnared in counterproductive behavior that may well be more costly than beneficial to its aims. The contractor is, of course, a loser. And, most importantly, the likelihood of injury to civilian and military personnel is substantially increased. As the Government expands its procurements into more and more sophisticated and exotic products, these problems can only worsen.

LEGISLATION SEEN AS SOLUTION

The solution lies in a legislated remedy. I think this hearing is a step in the right direction. As a former professor of mine once remarked, quite perspicaciously, there is no problem until you perceive a problem, and I think we are at least perceiving the problem at this point.

I hope that all concerned parties working in concert can produce a comprehensive, well-drafted piece of legislation which will provide an effective solution to this growing and critical problem.

I want to thank you and your staff for the opportunity to express my views, and I would be glad to respond to any questions you might have.

Senator **Grassley**. You feel all right then for a few minutes at least?

Mr. **Tobak**. Well, yes.

Senator **Grassley**. Is there not a form of accountability between potential plaintiffs and the Government, as evidenced through the Federal Employees Compensation Act and the Veterans Benefit Act?

Mr. **Tobak**. That is a great question and it is one I have asked myself. I think there is, but I think it is much more limited than a full airing that an action for indemnification or contribution would produce. I think that the workmen's compensation acts are geared more to compensation rather than to assessing fault, and my impression is that in compensating or allowing minimal compensation, the assessing of fault is lost in the bureaucratic maze.

Senator **Grassley**. Do you have any feelings on whether or not we should override the Supreme Court's reasoning in the *Feres* and *Stencel* cases?

Mr. **Tobak**. That is another very good question. The Supreme Court articulated three reasons why they felt indemnification or contribution should not be allowed to third parties. One of those reasons was the unique relationship of the contractor to the Government and the desire to avoid nonuniformity in result caused by difference in local State product liability laws.

I do not find that argument particularly persuasive, particularly when you realize that other agencies are also subject to this sort of local law.

The second argument, which is that there is a limit on liability of the Government under the Veterans Benefit Act to military personnel—while I think it has some legitimacy with regard to veterans I just do not see it as being legally required in terms of transferring that limit to third-party indemnification actions. I do not think, if there is a limit set up, it would apply to a third-party indemnification or contribution action.

The last reason, which I find very unconvincing—is that military discipline is going to deteriorate if we allow these sorts of suits to go on.

It seems to me that by the time you get to a third-party indemnification or contribution action, a deterioration process has already taken place and military discipline is far past resurrecting or saving.

Senator **Grassley**. On another point, do you think that it is realistic to advise Government contractors to raise their bids to cover potential liability? In other words, I suppose that would be the Defense Department position.

Mr. **Tobak**. As a scholar, rather than as a practitioner, the arguments that I have seen have indicated that it is really very difficult to raise contract prices to adequately cover or factor in a risk premium, and given the near monopolistic power of the Government over the bidding process, I just do not think that that is feasible. Again, I think this area requires empirical study.

Senator **Grassley**. What about the mere fact that we might suggest that that is what they should do, even if they do not have the capability of doing it, because of competitive bidding?

Mr. **Tobak**. I think if that happened, a number of the people, if you simply suggested that they do it, while they could put it in their bid prices, they would be unsuccessful. And I suspect that a number of the best and the brightest and the most conscientious contractors would be either frightened off or scared off from entering into the bidding process. I think this would be a problem for the Government and we would be left with people who would be contracting or bidding on contracts who would be less conscientious, less risk averse.

Senator **Grassley**. There is one factor there, I suppose, that we have to consider that I have not considered yet, and that is how such a practice, if it goes on—and there is some indication that it might—how it applies to sole-source contractors, which are a high percentage of our contractors.

Mr. **Tobak**. I really do not have an answer for that.

APPLICATION OF STRICT LIABILITY THEORY

Senator **Grassley**. On another point, I would like to have you elaborate on the strict liability theory as it applies to government contracts. Specifically, may a contractor submit a functioning product to the Government which, in turn, alters it, that alteration causing damage to the nonserviceman? What is the likely result?

Mr. **Tobak**. If, in fact, the manufacturer or contractor followed Government specifications without altering the product and complied, and the specifications were in error or flawed in some way, then the liability would still attach to the Government contractor and the Government would not be liable for injuries to Federal civilian employees. I am not sure if that is responsive to your question.

Senator **Grassley**. Yes. What about if that claimant is a serviceman?

Mr. **Tobak**. The same situation would apply.

Senator **Grassley**. Could you give us a rundown on what contract protections are available to Government contractors?

Mr. **Tobak**. Well, at this point a couple of the legal protections are the Government contracting defense—and the Government contracting defense has very, very limited use. Its clearest articulation was in the agent orange product liability litigation by Judge Pratt, who has called that action the case of the millenium.

There have been a couple of State courts in New Jersey and New York which have adopted it, and I think one in Illinois. But for the most part, the Government contracting defense has not been accepted. The 4th, 5th, 8th and, I believe, 10th circuits in various cases have either ignored the defense or actually rejected it.

Senator **Grassley**. Is that the case where the contractor is an alter ego for the Government?

Mr. **Tobak**. A couple of those cases involve the contractor as an alter ego. Their claim is that we are simply an alter ego for the Government.

Senator **Grassley**. Do you think that the development of a widely accepted Government contract defense is a likely prospect?

Mr. **Tobak**. No. I don't believe it is. I am not particularly partial to a Government contract defense. I am not partial to it because I do not feel that it effectively protects the interests of military personnel who might possibly be injured. It certainly insulates a contractor from liability; it shelters. It allows the contractor to shelter behind the sovereign immunity shield of the Government, but it really does not respond to the question of attempting to minimize risk by reintroducing fault into the system.

Senator **Grassley**. Well, Professor Tobak, I thank you very much for your testimony. We appreciate your bearing with us as long as you have as we know you are under the weather, particularly considering the fact that I was an hour late. Thank you very much.

Mr. **Tobak**. Thank you.

[The prepared statement of Mr. Tobak follows:]

PREPARED STATEMENT OF JAMES W. TOBAK

Good morning Mr. Chairman and members of the Subcommittee. My name is James W. Tobak and I am a Professor of Law in Lehigh University's College of Business and Economics. I am pleased to have this opportunity to appear before you today and express my views regarding the practicability of providing for a scheme of contribution or indemnification of Government contractors in appropriate circumstances. Before discussing the practicability of such a scheme, I'd like to take a moment to outline what I regard as the inadequacies of the current system.

I. THE PRESENT SITUATION: CUL DE SAC

I'm sure you are familiar with the status of the law regarding the liability of Government contractors to civilian federal employees and members of the armed forces injured incident to their employment or service. While I won't go into the law at great length, I will restate in basic terms the legal dilemma confronting the Government contractor. For a lengthier, more complete discussion, I would refer you to my article, A Case of Mistaken Liability: The Government Contractor's Liability for Injuries Incurred by Members of the Armed Forces, 13 Public Contract Law Journal 74 (July 1982).

The convergence of three distinct fields of law, sovereign immunity, strict product liability, and Government contracting, has created an unusual liability situation for the Government contractor. Contracted to supply a product according to Government specifications, and possibly even using materials provided by the Government, a contractor can comply completely with the specifications and still be held liable by a civilian employee or serviceman injured by the product incident to their employ or service. This liability holds even when the defect in the product that caused the injury is directly attributable to Governmental error in the design or specifications. The Government contractor is also precluded from seeking indemnification or contribution from the Government even though he may have acted reasonably and carefully.

It is well settled that where the injury occurs incident to Government employment or military service, the victim is restricted in the remedies he/she can seek against the Government. Specifically, the compensation schemes set up pursuant to the Federal Employees' Compensation Act and the Veterans' Benefit Act set the limits of recovery against the Government. In the military context, the Supreme Court, in Feres v. U.S., 340 U.S. (1950) concluded that the Government is insulated from further liability under the doctrine of sovereign immunity.

Whereas the Government is insulated from liability other than that incurred under the FECA or VBA, the Government contractor, particularly under the relatively recent developments in product liability, is made incredibly vulnerable to suits by those civilian or military personnel injured by the contractor's product. (There's no doubt that strict product liability makes any manufacturer or seller more susceptible to liability than in the past, however, in the context of Government contracting, this susceptibility is particularly onerous.) In a strict product liability action the claimant need not show fault (negligence) on the part of the contractor; all that must be proven is that the product was defective, the defect existed when it left the Government contractor's control and such defect was the cause of the injury. Although strict product liability does not entail automatic or absolute liability, the doctrine does make it far easier for the claimant to establish liability. The ease of establishing liability might well be facilitated by Government testimony that in fact flaws in the design or specifications themselves caused by Government miscalculation did result in the production of the defective product. Even such an outright admission of Governmental error would not under the current law protect the contractor. Parenthetically I would add that although some courts are fashioning a defense for the protection of the contractor, I find it to be unsatisfactory. The Government contract defense, as it is called, allows the contractor to shelter behind the Government's shield of sovereign immunity if he can show that (1) the Government established the specifications for the product or service, (2) the contractor completely complied with the specifications, and (3) the Government was as knowledgeable, if not more so, about potential hazards of the product or service as was the contractor. See Agent Orange Product Liability Litigation, MDL No. 381 506 F.Supp. 762 (E.D.N.Y.) (1980) rev'd 635 F.2d 987 (2d Cir. 1980); see also, Casabianca v. Casabianca, 428 N.Y.S. 2d 400 (S.Ct. Bronx, 1980); 364 A.2d 43 Sanner v. Ford Motor Co., (N.J. 1976). Because it simply shifts the loss from the contractor back onto injured claimants, I don't feel the Government contract defense adequately protects the interests of those injured or potentially injured.

The Government contract defense aside, the situation as it now stands allows the contractor to be sued for what might well be primarily or even exclusively the error or fault of the Government. The liability dilemma is compounded because the Government contracting context makes it difficult for the contractor to bargain with the Government over design or contract specifications once a contract has been entered into even if he subsequently detects a flaw in the design or specifications. As has been pointed out in testimony before the House on the same subject:

> Every Government contract, by operation of law and specific legislation and regulation has a disputes clause in it. The disputes clause requires that the contractor perform as directed by the United States. Failure to perform in accordance with those directions is a breach of contract. If the contractor disagrees with the order of the contracting officer, he may litigate it, but while litigating he must perform.

[Testimony of Fred Israel Esq., Counsel, Stencel Aero Engineering Corp., Hearing on H.R. 1504 before the Subcomm. on Administrative Law and Governmental Relations of the House Comm. on the Judiciary, 97 Cong. 1st Sess., ser. 12 at 18 (March 18, 1981).]

Institutional and policy pressures on Government agencies to produce results may lead to a lack of caution or a lack of risk minimization on their part; subsequently, because of the disputes clause, the contractor may become effectively locked into the responsibility for unwise or even dangerous performance. This latter contractually created compulsion to continue performance, even in the face of a potential danger, is not the general practice in commercial contracting.

The disputes clause is but one example of how the Government can, through its near monopsonistic powers, dictate the terms of Government contracts. In the context of Government contractor product liability, another important aspect of this extreme bargaining power is the Government's ability to effectively set its own contract prices. By virtue of this leverage it is unlikely that a contractor can factor into the contract price an appropriate risk premium and still successfully compete for the contract. See Stabile, Tort Remedies for Servicemen Injured by Military Equipment: A Case for Federal Common Law, 55 N.Y.U. L.Rev. 601, 608 (Oct. 1980). In essence, contractors who are successful are themselves bearing the risk of liability for potentially defective products. The contractor is thus caught in a vise that finds him squeezed between strict product liability, the exigencies of contracting with the Government, and sovereign immunity.

In 1977 the Supreme Court in Stencel Aero Engineering Corp. v. U.S. 431 U.S. 666 (1977) transformed the vise into a noose by extending the Government's sovereign immunity to third party indemnification or contribution actions. See also, Thomas v. Lockheed Aircraft Corp., 665 F.2d 1330 (D.C., 1981) cert. granted sub nom. Lockheed Aircraft Corp. v. United States (No. 81-1181); Kudelka v. American Hoist & Derrick Co., 541 F.2d 651 (7th Cir. 1976). The Government contractor is now not only subject to direct product liability for what may well be the Government's wrongdoing but is left literally dangling over a precipice of potentially devastating liability without recourse to Government indemnification or contribution.

I would emphasize that denying indemnification or contribution is not the general commercial rule. This is particularly true where the seller (i.e., the contractor) is passive in creating the defective condition and the third party's (the buyer's) conduct actively causes or creates the defective condition. See generally, Hursh and Bailey, 3 Products Liability, § 18.7 at 95-100.

The Agent Orange Product Liability Litigation MDL No. 381, 506 F.Supp. 762 (E.D.N.Y. (1980) rev'd 635 F.2d 987 (2d Cir. 1980)) highlights the Government contractor's predicament. Although the facts remain in dispute as to whether Agent Orange actually harmed the claimants (numerous Viet Nam veterans and their progeny) and, if so, to what extent the chemical companies who manufactured the product for the Army were at fault (relative to the Government), a federal district court has ruled that the Government is immune from liability. The amount being sought as compensation, between four and 30 billion dollars, is estimated to be more than the combined liquid assets of all 19 chemical company defendants. Without hazarding a guess as to the outcome of the litigation, the enormity of the action and its potential impact on the companies involved does dramatically illustrate the dangers confronting Government contractors under the current liability laws. For smaller companies, far smaller liability may prove ruinous.

II. DISINCENTIVES TO THE EXERCISE OF DUE CARE

Beyond creating an inequity in exposure to liability for the Government contractor, the current patchwork system may well add to the dangers that civilian and military personnel face from defective products. If one puts any credence in the traditional tort notion that financial responsibility/accountability is a critical incentive for encouraging people to exercise more--rather than less--care, skill and caution in the conducting of their activities, then insulating the Government from liability is counterproductive logic. See W. Prosser, Law of Torts § 4 at 23 (4th ed. 1971). Insofar as the current laws create an asymmetry or imbalance in exposure to liability, the Government's incentive to exercise maximum caution, care and skill is reduced rather than increased. As a lawyer, a law professor and a one-time Boston cab driver, I adhere to the traditional wisdom and I believe people will tend to be more careful and cautious when faced with the possibility of financial liability. Thus I find the current laws, insofar as they combine to insulate the Government from liability other than that imposed under the FECA and the VBA, to be both incomprehensible and pernicious.

The Stencel Aero case furnishes a good example of how insulating the Government from product liability may have the tendency to increase rather than reduce the probability of injury. Evidence indicated that Stencel had warned the contracting agents of a flaw in the egress life-support system (ejection unit, parachute and parachute container) they were subcontracted to supply for use in F-100 and F-102 aircraft. For whatever reason, the Government agents ignored the warning and insisted that Stencel continue producing the units according to their specifications. The result was a fatal injury to one National Guard pilot and a serious injury to another--injuries that the Government concluded were caused by the defect noted by Stencel. Similarly, one of the claims of the chemical company defendants in the Agent Orange Product Liability Litigation is that they warned the Government of potential dangers from excessive exposure to dioxin, a chemical ingredient of the defolient Agent Orange. It is further contended that despite this warning the Army exposed hundreds of thousands of military personnel in Viet Nam to excessive doses of dioxin. One has to wonder if the institutional pressures that cause Government agents to push ahead with contract performance or to use a product in a particular way might well be counterbalanced by Governmental financial accountability?

Ironically, under the current system, the Government may well be a victim of its own immunity. As has been suggested in prior testimony before this Subcommittee by T. Richard Brown, counsel for TRW, the liability trap facing the Government contractor may make it highly unlikely that the most responsible, risk averse contractors can successfully compete for Government contracts. The liability trap might serve to frighten some of the best contractors out of the competition. In limiting the pool of competitors, the Government increases the chances that those who are successful may be the most careless and least responsible contractors generally. Although somewhat speculative, I think this is an argument that must be given careful consideration.

Similarly, if one accepts the proposition that the current liability laws tend to increase rather than decrease negligent behavior, and thereby increase the danger from defective products, Government immunity may well be counterproductive. Given what I would imagine to be high disruption and replacement costs associated with the loss of personnel, materials and equipment, the Government suffers losses to the extent to which current laws fail to discourage reckless or negligent conduct. Without knowing the extent to which these losses offset the gains of immunity, I certainly think they are a factor that must be carefully considered.

III. EXISTING LEGAL AND PRACTICAL OPTIONS

None of the existing alternatives adequately deal with the inequity of the current liability system nor do they resolve the problems created by that system. The contractor's legal defenses to a product liability action by injured civilian or military personnel are severely limited. Even a possibly effective defense like the victim's assumption of the risk is readily parried if the victim can show he was simply following a superior's orders. See O'Keefe v. Boeing Co., 335 F.Supp. 1104 (S.D.N.Y. 1971); Montgomery v. Goodyear Tire and Ribber Co., 231 F.Supp. 447 (S.D.N.Y. 1964) aff'd. 392 F.2d 277 (2d Cir. 1964) cert. denied 393 U.S. 841 (1964). As previously mentioned, the Government contracting defense would extend the Government's sovereign immunity to the contractor where the defective condition was caused by Governmental error. Nevertheless, this does not address the underlying problem of attempting to minimize the risk from defective products. In fact by insulating the contractor as well as the Government from the direct actions of those injured, the Government contracting defense may aggravate the existing problem.

A handful of very specifically framed indemnification or contribution statutes have been passed to provide some relief for a narrowly defined group of Government contractors. For instance, Congress has passed indemnification legislation with regard to liability arising from nuclear accidents (42 U.S.C. § 2210 (Price-Anderson Act)); the administration of the swine flu vaccine (42 U.S.C. § 274b); and the contamination of dairy products by nuclear radiation or toxic chemicals (7 U.S.C. §§ 450(j) to (i)). Somewhat less specific statutes provide for indemnification in "unusually hazardous" risk situations, arising out of either military research and development contracts (10 U.S.C. § 2354) or contracts furthering the national defense (50 U.S.C. §§ 1431-35). Although broader than the specifically framed statutes, these latter indemnification statutes are considerably narrowed by the limited definition the agencies have given to "unusually hazardous." Even when combined, it is clear that the existing indemnification statutes do not provide anywhere near adequate protection for the liability exposure faced by the vast majority of Government contractors.

In addition to these limited statutes there is also the possibility of post-liability private indemnification bills being introduced and passed in Congress. This of course is a rather unsatisfactory legal option in that it depends upon unknown political/legislative variables. It is also primarily geared to compensation rather than accountability and therefore does not adequately address the problem of risk minimization.

Existing practical options like product liability insurance and offering higher contract prices as a form of self-insurance have clear shortcomings. Insurance, when available, may be so costly as to effectively eliminate it as a real possibility, particularly for the smaller contractors. Also, insofar as insurance protects only the contractor against loss and is a charge against his operations, it does not address the issue of risk minimization on the part of the Government agency.

The notion that the contractors could raise their bid prices to cover the liability risks is an appealing economic assumption, but as previously mentioned, the constraints of the Government contracting process makes it an unlikely option. Given the Government's near monopsonistic power to set purchase terms, those who factor in such a cost would probably lose out in the competition for Government contracts. Moreover, even if such an option were feasible, it would still leave the risk minimization problem unresolved. Indirectly transferring liability costs through the pricing mechanism would not adequately expose the party whose fault caused the injury. In fact, covering the liability risks in the contract price would have the undesired effect of shielding the Government contracting agency from the consequences of its errors and therefore it would not discourage negligent action in setting the specifications of the contract.

Inclusion of indemnification clauses in Government contracts is a very attractive, albeit impracticable, solution. Geared to reflect fault, contract indemnification clauses could both solve the liability inequity and also operate to encourage risk minimization. However, without an express requirement by law or policy, Government contracting agents are apparently reluctant or unwilling to exercise the initiative and include clauses that might expose the Government to increased liability. Moreover, given a recent Comptroller General ruling that casts doubt on the legality of obligating Government funds for undetermined future liability, it would seem even less likely that contract agents would elect to include indemnification clauses in Government contracts (Comp. Gen. Decision B-201072 May 3, 1982). In the rigid context of the Government contracting process, this solution, based on the discretion of Government agents, seems infeasible.

In summary, the current legal anomaly creates a liability dilemma for the Government contractor, potentially works to expand the class of those injured by defective products, and very likely ensnares the Government in counterproductive behavior. Existing legal and practical options provide a patchwork solution that neither sufficiently protects contractors nor adequately responds to the problems created by the current distorted liability system.

IV. FORMULATING A SOLUTION

The difficulties engendered by the current laws could be rectified by comprehensive, well-drafted legislation. The drafting of such legislation will not be an easy task given the variety and complexity of interests, those of the Government, the contractors, insurance companies, potential victims and claimants that must be accommodated. The uppermost objective, however, must be the minimization of risk and injury and the concomitant reduction of the sum total of liability. To achieve this end, legislation that links liability to fault through a systematic scheme of Government indemnification and contribution is crucial. However, such a scheme cannot be so broad as to expose the Government to inappropriate liability. Overly broad Government liability would produce the undesired effect of relieving contractors of liability for their wrongdoing and thereby reduce their incentive to minimize risk. Keying liability to fault in a systematic manner is a critical feature of any legislation designed to correct the deficiencies in the current system.

As the subjects of Government contracts become increasingly sophisticated and exotic, the possibilities of unknown and unforeseeable defects occurring increases. Where the risk was unforeseeable and there is no fault, liability cannot be apportioned on that basis and it would appear that a provision that the Government share equitably in the loss would be appropriate. Liability arising from unavoidably defective products made at the Government's behest and for Government use should not be borne entirely by the contractor. Losses from such unavoidably defective products ought to be regarded as social costs; to do otherwise would needlessly and unfairly jeopardize contractors as well as make it more difficult for claimants to recover.

The procedures for obtaining indemnification or contribution cannot be so cumbersome or onerous as to effectively thwart the contractor's efforts. To tie contractors up in costly, protracted litigation might well defeat the very purpose of remedial legislation. Expeditious procedures, more administrative than adversarial in tone, designed primarily to ascertain fault and apportion liability should be instituted. If a genuine dispute of fact exists, obviously the legislation must provide some mechanism for litigation, but litigation must be conceived as a secondary avenue for obtaining indemnification and contribution.

The National Association of Manufacturers draft bill on Government contribution and indemnification has provisions which go far to rectify the problems with which I am concerned. In particular, Section 5, Government

Contribution to Suppliers, which links the amount of Government liability in the form of contribution) to the degree of fault, is consistent with the goals of risk minimization and the overall reduction of injury and liability. This section alleviates the obvious inequity of holding the contractor solely liable for the Government's error. Moreover, the comparative fault feature of the draft bill gives both the Government and the contractor an incentive to avoid wrongdoing. The proposed procedure for seeking contribution is appropriate insofar as it attempts to avoid litigation and establishes a preferred route that encourages reasonable efforts on the part of the contracting agency, the Attorney General and the contractor to reach an agreement. However, one shortcoming of the draft is that it does not specifically provide for the sharing of liability arising from unavoidably defective products.

The current liability cul de sac is all too easy to dismiss off-handedly. The Government appears to be a winner whereas the Government contractors, a group not likely to garner a great deal of public sympathy, appear to be the only losers. This unfortunate perception glosses over the serious problems and distortions created by the current system. The Government is ensnared in counterproductive behavior that may well be more costly than beneficial to its own aims; the contractor is of course a loser; and most importantly, the likelihood of injury to civilian and military personnel is substantially increased. As the Government expands its procurements into more and more sophisticated and exotic products, these problems can only worsen.

The solution lies in a legislated remedy. I think this Hearing is a step in the right direction. I hope that all concerned parties working in concert can produce a comprehensive, well-drafted piece of legislation which will provide an effective solution to this growing and critical problem.

Thank you for the opportunity to express my views.

Senator **Grassley**. I would also suggest for all of our witnesses, past as well as future for this hearing, that even though there are not other members of the committee here today because of scheduling conflicts, it is sometimes a practice that you might have other committee members send questions to you for answers in writing. So if you would get such requests from other committee members, I would appreciate it very much if you would answer these in writing as well.

Also, as a matter of fact, since there is a prospect for a third meeting, for those in the audience who are not on the witness list, if you have a desire to submit testimony in writing, that would also be received for the committee's consideration.

I have the pleasure of introducing a friend of mine whom I have known for at least 10 years, and maybe even longer than that, Mr. Ted Johnson, who is president of J-TEC Associates, Inc., of Cedar Rapids, Iowa. Mr. Johnson's firm has been contracting with the Government for over 30 years, primarily in the field of electronics.

We are pleased to have the benefit of your experience, Ted, in this field. And even though it is not pertinent to this particular discussion, besides being president of this corporation, he has been a civic-minded individual in Cedar Rapids, and also very active in the Republican Party and a former member of the State central committee of my State of Iowa, and a leader in many areas of Republican activity.

I want to thank you for that personally, and thank you on the part of the committee for participating in this testimony. Would you proceed?

STATEMENT OF THEODORE A. JOHNSON, PRESIDENT, J-TEC ASSOCIATES, INC., CEDAR RAPIDS, IOWA

Mr. **Johnson**. Thank you, Senator. Mr. Chairman, it is a pleasure to be here and to add some small-business input into the consideration of this issue.

As you have stated, I do function as the president of a small business. Part of those 30 years were with large business; namely, Collins Radio Co. out of Cedar Rapids, Iowa. I am also a director of the American Association of Small Research Companies, whose goal is to enhance and increase the amount of high-technology development funding from the U.S. Government for small businesses.

I do not represent any other small business association, nor are we a member of the NAM. I did serve as a small business person on the Commission on Government Procurement, Study Group 8, which, among other things, considered the question of liability.

J-TEC operates like most small firms, and just as an example of the kind of thing that we represent in small business, we set about to find a new way for sensing the environment. We found out that what makes the flag wave is a physical phenomenon that was very precise and repeatable. And we found, electronically, a way to sense the turbulence that is created behind any obstruction in the fluid flow.

That led, after we had discovered this phenomenon, to the development of an anemometer that is used on the national data buoy program of the National Oceanographic and Atmospheric Administration. It is also an air speed indicator and it is now a production item on the Aquila program out at Lockheed—a battlefield drone program. It is a wind speed and direction sensor on a DIVAD tank at Ford Aerospace. It is a potential crosswind sensor on the M1 tank, and is being considered for that on the basis of its cost effectiveness, by the way.

It is used as a flow meter and as a spirometer, which is used in life support systems for pulmonary function generators. And I might point out that we do not build that; we license it to a company that could afford the kind of risk protection that one would need where you are dealing in life support.

It is also used by the Europeans in the atomic energy environment, and is used quite widely in that technology under licensed people supplying the United Kingdom Atomic Energy Authority. But it is not sold by us to our Atomic Energy Commission because of the risk that that would involve, and we have not even attempted to do that, even though it is used widely in Europe.

We are just typical of the kind of small business that I want to speak for, where people go out to solve a problem in an entrepreneurial spirit. Some governmental agencies find out that you have some new technology, and small businesses grab at that opportunity. The liability that is inherent in what they may do is clearly outweighed by the advantage that that Government business gives a small concern as a startup operation.

But as they grow and accumulate assets and become a growing concern, they begin to take a closer look at these kinds of things. Since I was on Study Group 8, for example, back in 1972 to this very moment, I have not spent much time worrying about product liability as it relates to the issues with the Government. We did cover ourselves as best we could with product liability and took protection measures on our products.

But as we see the recent case law that has come up, particularly *Stencel* and others, and as we looked at the jury awards that have become astronomical, in my judgment, and, indeed, as I prepared for the statement today, I decided that there was no alternative but that I must appear to support the kind of draft proposal, for example, of the NAM and the other industry statements in your first hearing. And I want to urge you to use those approaches to resolve both the hazardous insurance risk and the strict liability problem.

I think there are two or three things that I would just mention about the effect of not doing or doing something about this kind of legislation will have on small business. I do not doubt that small business will still go after it, despite the early risk. Most of us do not understand the liability situation clearly; it is a very complex subject. Even I, being a lawyer by training, find it very difficult to wade through all the nuances of the kinds of case law and regulations that we have to deal with.

Frankly, in the early days small businesses do not really care about it. They are willing to say, well, everything is risk, so what is this? Just more of the same, really. But there was a case of corporate director liability not too many years ago. No one was concerned about directors' personal liability, but once it became known that there had been decisions holding directors responsible for the acts of their corporations of which they were directors, it was not very long before even small businesses were paying the price for director liability insurance.

I think that as the perception of what we are talking about and you have been talking about in this legislation becomes more widely understood by small business, it will not take very long before it is a very serious problem. And my guess is that it will, in fact, do what has been subjected by so many others: induce small business to take a second look even in the beginning about becoming a Government supplier.

In the face of what the Government is trying to do in the Small Business and Innovation Development Act and some other programs under agencies of the Government to increase small business participation, I think this liability risk is counterproductive and I think the liability problem really needs to be reduced to something reasonable and understandable to small business.

INADEQUACY OF INSURANCE COVERAGE

I just would point out one other thing about small business, and I relate it to myself, but I think it will probably be standard in our kind of industries. The cost and availability of liability insurance is affected by two things. No. 1, there is a real cost. No. 2, it is awfully hard for us to determine how much insurance we need and what part of that vast, unexplainable risk we ought to cover.

In our case, for example, we have a $3.5 million umbrella policy. As I reviewed it preparatory to coming here, I found out, first of all, that we do not have any personal damage coverage on nuclear kinds of risk at all. We have got no property damage on nuclear risk, except in the United States and Canada. What is worse, we have no air vehicle product coverage, so any product we make—and we make several of them that end up on air vehicles, airplanes and drones and the rest—are not even covered by our insurance.

I have asked our insurance agent a lot of questions and I still do not have answers as to what kind of maximum coverage you could get and what kind of price it would be. Indeed, he suggested that asking the questions of the insurer and the insurance company was a risk to us because if we began to suggest that we had a lot of risks that were dangerous risks, they might begin to wonder whether they ought to issue the insurance at all to our company.

The proposed legislation that I have seen submitted to your committee, I think, provides a model of risk versus available coverage in a way that small business could expect to be able to get the necessary private insurance that it could reasonably afford. And without it, I think it really leaves the question of liability coverage undefinable and practically unavailable to small business.

I just want to make one point in regard to the Office of the Attorney General statement, where he has made a specific case in two or three instances where the drain on the Treasury as a result of this, where there are none of the usual restraints on payments by the Government, would be something to avoid. He talks about the limitations on tort making sense because the Government "will not be visited with novel and unprecedented liability," and suggests that this should not be considered because of the enormous additional cost to the taxpayer.

I submit that what is good for the goose ought to be good for the gander, and I think that same problem is a problem for small business and large business. I do not think it is fair from the point of view of the injured party to have something vague and undefined, as we have to face it in small business at the moment—it is just kind of a random coverage. If the Government has not assumed any part of that responsibility, they are going to find a lot of people injured who cannot get recourse from at least small business people because they are not going to be adequately covered.

I heard the testimony from the Department of Defense and I have a long dissertation in my statement in regard to the process by which the Government procures. There are a lot of tradeoffs that go into establishing the final specification. There are a lot of things in specs that are not just equipment specs that tell you how careful you have to be in the manufacture, and all the rest of it.

But when they are all done, they do include a warranty clause because they want to cover the fact that these units are not going to work forever. They have meantime between-failure specs in their equipment operation specs, and a spare parts requirement which expects that they have got to be repaired.

All of these, you know, anticipate that the equipment is not going to last forever and it is not going to work all the time. Yet, once it gets out into the Government's hands, at least in the case of the strict liability problem, the contractor no longer has any control over what happens to it, but he certainly has the costs to pay if something happens to an employee of the Government, a military person.

So I urge you to take very serious consideration of these proposals, Mr. Chairman, and I would be happy to answer any questions.

Senator GRASSLEY. I do have some questions that I would like to discuss with you. First of all, thank you for your testimony, and it is very informative and illustrative. We appreciate that very much, particularly from the standpoint of your being a smaller contractor and the problems, obviously, that they share dealing with the Defense Department, much as small manufacturers are particularly affected when it comes to product liability matters in the private sector.

Since you brought up the subject of the insurance that you have, I would like to ask you if you have any way of knowing what percent of the contract price goes toward the insurance premiums. Have you ever figured that out?

Mr. JOHNSON. Just on the level of which we now have for protection, which is grossly inadequate, I might add, after having reviewed this, we are looking at something, on the $3.5 million coverage, of about three-quarters of 1 percent of our selling price.

If one were to get up to a maximum of $60 million on that same kind of policy, which excludes a lot of risk coverage, we would be looking at something closer to 1½ to 2 percent. It is not, in terms of recovery, all that big a problem, but at the same time it is inadequate coverage.

Even covering it on that basis, I have got no way, nor has anybody else any way of knowing whether we really have made a good judgment about how much risk is out there.

Senator Grassley. Do you have any bargaining power at all when a contract is formed, or is the contract primarily composed of boiler plate language that you find it very difficult to change?

Mr. Johnson. Well, it is very difficult to change a position, particularly if it is an agency-adopted regulation and it is in their regulations. Ordinarily, suppliers get all that fine print and you work out the things that are most critical.

But in small business activities, most of the procurement is fixed price. It often is competitively advertised business. If one were to try to take an exception to one clause or another, particularly if inclusion or exclusion would be a price differential factor, I think he would be risking his opportunity to get the business at all.

I would not even attempt in a case of this kind to expect to get the contracting agency to alter their policy in the case of a company like ours, and I do not think any other small business would.

Senator Grassley. Have you had any suits filed against you in your capacity as a Government contractor?

Mr. Johnson. We have had a potential suit in the case of an anemometer of an ocean buoy, which has not come to pass and I suspect it will not come to pass. But all of those products that I cited are used in not ultrahazardous but in risk situations.

A boat damaged the buoy; the buoy was giving weather information. The weather information was said to have excluded the wind information because the wind sensor was damaged by the boat. Depending on the parties now involved—if it were a Government employee, for example, who now had an accident at sea because of bad weather information, they could then refer that back to us under the strict liability principle, and it would have been a disaster. We would have been out of business.

As it turns out, the parties involved were not so alined, but that was just a circumstance of chance.

Senator Grassley. What is your reaction to the Department of Justice's reasoning that the fact that considerable visible effort goes into the competitive battle to secure an edge in receiving this business speaks eloquently against the argument that an expansion of the indemnification is necessary?

VIEW OF BIG AND SMALL BUSINESS

Mr. Johnson. Well, from the point of view of small business, I think you see the perception of big business and they are not going to tolerate it very much longer; from the point of view of small business, it is really just taking advantage of their eagerness to be a part of the system. I think that is well-spoken that we still fight to get a good piece of the Government contract business because it does so many things for a growing company.

But as small business now begins to see the peril of that, I think that is going to change. And I really think that it is an intimidation in any event on the small business community to say, "We are going to make you take it and if you like it, go ahead and have at it." That is not a very reasonable way to solve the problem.

Senator Grassley. That is the last question I have, so thank you very much.

I also wanted to announce that it is my intention to go right through. I hope that is all right, not to recess for lunch or anything, because I think we can have this hearing completed in less than an hour.

Mr. **JOHNSON**. Thank you, Mr. Chairman.

Senator **GRASSLEY**. Thank you.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF THEODORE A. JOHNSON

I am Theodore A. Johnson, President of J-TEC Associates, Inc., a small business in Cedar Rapids, Iowa. Prior to organizing my own business in 1968, I spent 13 years with Collins Radio Company as a Contract Administrator and have been closely associated with negotiations of government prime and subcontracts since 1952. I was a Small Business member on Study Group 8 of the Commission on Government Procurement whose recommendation on the subject of liability under Government contracts has been referred to in the earlier hearing of this subcommittee.

In many ways J-TEC typifies the small high technology company that often becomes a Government supplier One or more enterprising employees of a larger company decide they would like to go into business for themselves. They develop a strategy for a product and marketplace based on advanced state-of-the-art, or determine to develop a new technology to serve existing market needs. That market may be either Government, commercial or a combination of both. In our case we felt new instrumentation techniques were needed in the oceanographic and atmospheric areas and shortly after founding our company, we developed a new technique for measuring the flow of liquids and gases. From its initial application as a no-moving part sensor for the measurement of wind speed and direction, its unique properties led to the development of a wide number of both commercial and military applications. These include:

1. Use as a wind speed sensor on the National Oceanographic and Atmospheric Agency's large ocean weather platforms, other weather stations, and ships.
2. As a low range air speed indicator for helicopter use.
3. As an airspeed indicator for the Army AQUILA drone program under subcontract to Lockheed.
4. As a wind speed and direction sensor on the Ford Aerospace Sgt. York anti-aircraft gun vehicle (Army DIVAD Program).
5. As a potential low cost replacement for the crosswind sensor on the General Dynamics M1 Abrams tanks through a recent award of a subcontract for field evaluation quantities on that program.
6. As a flowmeter for measuring gases, designed for the commercial market, but because of its unique properties; often sold to military laboratories and other government activities.

7. An early development licensed to Bourns, Inc., applying the sensor to the control of pulmonary function generators and life support systems in the medical field measuring the amount of air in and out of lungs of patients. This application presented product liability risks of such magnitude that the company chose to license the technique to a major medical supply company established in that field.

These illustrate what happens to advanced state-of-the-art technology that is initially conceived and developed by small business. Because such developments may solve problems being encountered by conventional technology, there is often an attractive market for the development of products using that technology to solve specific needs of various government agencies. It is the nature of entrepreneurship to grasp such opportunities to enhance the technology and to take advantage of the revenues available to promote growth of both the company capabilities and its products. Usually in the early years of growth, the question of potential risk is far out-weighed by the advantage such opportunities bring to a small business concern. Once such a company has become a viable, growing concern, it then begins to look more and more carefully at what each new piece of business may mean to its long term stability. At this point too, a company may have obtained a significant enough asset position, unlike its early deficit years, that that asset position alone dictates increasing caution on the risks it chooses to undertake. It is during this transition and beyond that the question of liability being considered by this committee becomes increasingly significant. From the days when I worked on Study Group 8 with the Commission on Government Procurement to the present, these issues have not been a great concern to our company. However, a review of recent decisions, coupled with the size of jury awards in product liability cases, led me to take the time to appear in support of the kind of proposed legislation offered in the earlier hearing by the National Association of Manufacturers and supported by spokesmen from the industry. Indeed, the work required to prepare for this hearing has convinced me that small businesses generally are only beginning to realize the nature of the risk that they incur under present laws and regulations.

I have assumed all the legal background on both case law and regulations have been amply covered in the earlier testimony. I want to address the effect Congressional action, or the lack of it, will have on Small Business and Government Contracting with Small Business.

THE EFFECT ON SMALL BUSINESS

A Small Business will no doubt continue during its early years to accept whatever risk current regulations impose on it. This will be in part because small businessmen often are not familiar with the subtleties of the law and partly because they usually have so much at risk that even the knowledge of the liability under government contracts is viewed as just more of the same. As a company matures, more and more concern is paid to the risk in each new move; and eventually the value of the company dictates that every risk must be measured against the company's value to its owners. At this point, the impact of a growing recognition of the risk and the cost of covering the risk becomes most significant.

An analogous situation is the recognition by small business that there was personal risk to company Directors in the manner in which they served. Suddenly, as information regarding the Director's risk spread, small concerns were required to provide Director's insurance at considerable cost.

I believe the word on liability will soon permeate the small business segment of the industry, and will cause serious problems for small business.

1. The first and most important is that without reasonable legislation, small business will become less inclined to seek Government business. At a time when the Small Business Innovation Development Act is being implemented with the goal to increase small business proportionate share of government R & D, liability risk should be reduced to the level of reasonableness. Small business is already plagued with a plethora of regulations it can do little about but accept. Present available remedies are far too complex to be very useful to small business. The proposed approach offered by the National Association of Manufacturers provides at least an adequate solution for Small Business to identify the risks and adjust accordingly.
2. Cost and availability of product liability insurance is a major Small Business problem. J-TEC presently pays a substantial premium for a \$3½ million maximum coverage. This coverage does not include personal damages for products used in nuclear facilities and covers property damage only in the U.S. and Canada. It does not cover any liability for products used on air vehicles of any kind. Our agent was unable to quote the cost of full product coverage or even commit that it could be available at any price. The proposed legislation would provide a

method by which agencies and companies could match reasonable risks with available coverage in a way that small business could expect to be able to obtain the necessary private insurance. Without it, hazardous risk coverage and ordinary major liability coverage are both undefinable in limits and unavailable in any practical sense.

3. In the Statement of J. Paul McGrath, Assistant Attorney General given September 30, 1982 he speaks of the Department of Justice's opposition to indemnification in, among others the following terms:

   Page 1...."They [proposals for contribution or indemnification] would result in a significant drain on the public treasury without any of the usual restraints on payment....

   Page 5....The limitation on tort suits against the United States makes eminent sense. Congress has moved cautiously to ensure that the Government will not be visited "with novel and unprecedented liabilities as a result of expanded tort liability", Feres v. United States....;"because expanded relief would result in an enormous additional cost to the federal tax payer."

   To both these points I say, in regard to small business capability in assuming that same burden; - "If gold rust what will iron do?"

From the point of view of the injured party, a standard definition of who assumes what and how much risk, would provide something better than random chance of recovery from any small government contractor. This would seem to be a major benefit of legislation, particularly if Government Contracts continue to be sought after even if indemnification is not offered, as was suggested by the Justice Department Statement.

THE EFFECT ON GOVERNMENT PROCUREMENT

1. In its effort to provide the best possible defense, environmental protection or whatever else Agencies of the Government seek to do, it is axiomatic that they are always working in the most advanced state-of-the-art. Often this requires the use of experimental techniques leading to early prototypes. The original government requirement, covered by the masses of specifications for everything from paint to the most sophisticated performance requirement, is often impossible to meet. Compromises are made if the trade-offs of technical feasibility, time, performance and cost make it necessary. When a unit is approved for

production, those same amended specs apply, along with a most complete set of manufacturing standards for quality, reliability, maintainability and performance. The quality standards are reviewed, including the contract's system of control and inspection, and tests are established for each step in the production and test. Detailed records are kept to ensure the best possible product. Yet in almost every contract there is a provision for warranty that has limitations in time. Often there is an established mean-time-between failures. There are maintenance procedures, repair procedures, and spares support levels for field and depot repair. All such clauses assume there will be failures. Yet, once out of the contractor's control; there is no provision for contractor review of the government performance of those procedures. It seems awfully simple that, given the above scenario which could be amplified exponentially, that the application of strict liability only to the contractor, is grossly unfair. The Government should bear its proportionate share of liability as proposed in the draft legislation.

2. If some relief if not made available, the Government and its Contractors will be driven further to provide more and more redundancy in order to ensure that liability will not be incurred. While this is a noble goal, and there are cases where it must be the goal; near perfection, if it comes at all, comes at an asymetrically increasing cost to attain the last increment of error free operation. This would indicate an increasing cost of defense with little additional capability, unless judgement of the level of zero defects can be made without the specter of strict liability resting on the contractor alone.
3. Existing provisions for special cases are of little or no value to small businesses. There is intensive competition for government contracts, most of the small business awards tend to be fixed price, and the awards are based on price. In such cases, injection of negotiations about liability are not possible as a practical matter for small businesses. Flow down from Prime contractors to subcontractors falls in the same category.
4. J-TEC has had a number of product which carry with them examples that illustrate the risks under consideration.
   a) VA-300/320 Anemometers. A no-moving parts sensor for wind measurement. In the hostile sea environment, regular maintenance and

replacement of sensors is expensive and requires time to sail to the site. A faulty reading could result in failure to forecast a severe storm front with possible damage to Government and private vessels.

b) Vortex flowmeters, The same sensor measures flow in pipes, controlling burners, measuring oxygen and other gases. Failure to properly maintain, inspect and calibrate could cause serious damage.

c) Air Speed Indicators for helicopters and drones speak for themselves, as do mine air draft sensors. These mine draft sensors are considered by the Bureau of Mines to be the only practical unit for long term monitoring of air draft in mines to ensure no excess accumulation of explosive methane.

d) The flow technique is used by a licensee in Europe for their U.K. Atomic Energy Authority. J-TEC has not pursued similar requirements with our Atomic Energy Commission or Atomic Energy plants due to the extraordinary hazardous risks involved in that market and the insurance problem associated with it.

All of the above applications carry the potential for negligence by government employees to cause serious damage.

Objections to proposals to resolve this difficult problem area have cited the difficulty of administration. I recommend Congress proceed with legislation covering both catastrophic and strict liability risks and let the administration be worked out.

Chief Justice Earl Burger, in an address Burger gave before the Authur Vanderbilt Memorial Dinner in New York, discussed innovative ideas to reduce the load on an overburdened judicial system. He asked if there was really any need to have personal injury and property damage cases tried in the courts at all? Why not dispose of these claims as claims for workmen's compensation are handled, by administrative agency. I do not propose such a dramatic departure from the present, but I do urge you on behalf of Small Business to give very serious consideration to the NAM proposed draft.

Senator **Grassley**. Our next witness on the list is Mr. Charles Carey, senior attorney with Dow Chemical Co. Mr. Carey, I know, brings to this hearing Dow's experiences of being a defendant Government contractor in a class action where the damages could run as high as $40 billion. This is an amount admitted by the plaintiff Vietnam veterans as being greater than the combined liquid assets of the 19 defendant chemical companies.

Mr. Carey, we are certainly interested in hearing what you have to say because we know your company and many others are a living example of what this hearing is all about, and the public policy centered around that.

So I would appreciate it if you would proceed now, and then also I am going to have some questions I want to ask you. I would also ask you if you would introduce your colleague for the record.

STATEMENT OF CHARLES C. CAREY, SENIOR ATTORNEY, ACCOMPANIED BY STANLEY PIERCE, COUNSEL, DOW CHEMICAL CO.

Mr. **Carey**. Thank you, Mr. Chairman. I have with me today Dr. Stanley Pierce, who is also an attorney with the New York firm of Rifkin, Leff, Sherman & Radler, which represents the Dow Chemical Co. in the agent orange litigation.

First of all, I would like to thank you for this opportunity to express some of our views to the committee on this subject. The concerns of the business and industrial community are that equity and fair treatment be brought to an area where we believe that some injustices have been allowed to prevail.

Senator **Grassley**. Let me interrupt. I am sorry. There is a cloture vote, but I guess it is not right now. We are going to check that. If it is, then I would suggest that I go vote and I can be over there and back in 7 minutes. But you go ahead now, please, because these buzzers signify that we are just going into session. Go ahead.

Mr. **Carey**. I believe the historical approach to this problem has been commendable, but I think it falls short of a comprehensive solution. I know earlier witnesses have referred to some of the pieces of legislation and statutes that exist that deal with the problem in part, and some have referred to it as patchwork or hodge-podge, piecemeal, or whatever. But whatever we refer to it as, I believe that only a comprehensive legislative approach will provide us with a comprehensive solution.

Government contractors can be faced with a liability to a third party under circumstances where the contractor has not been negligent in any way whatsoever, but where the Government itself has been negligent. These problems, I believe, are quite real; they are certainly real for the Dow Chemical Co.

Rather than go over a lot of the testimony that was given by earlier witnesses, and earlier witnesses back in September, I would just like to say that we do support the NAM draft of the proposed statute, and the testimony of some of the earlier witnesses, such as Mr. McCloskey, Mr. Brown, Mr. Schwartz, and Mr. Baird.

EXPERIENCES AS GOVERNMENT CONTRACTOR

The Dow Chemical Co. has had three major experiences as a Government contractor. One was in operation of the nuclear weapons facility at Rocky Flats, Colo. A second one was the supplying of napalm to the United States during the Vietnam war, and the third was the supplying of agent orange to the United States during the Vietnam war.

The first experience as operators of the Rocky Flats nuclear facility was a positive experience. There were no particular difficulties encountered on our part. I think the Government lived up to its obligations and we lived up to ours. In the napalm experience, although we suffered a number of problems in the way of vastly increased security costs and death threats to our employees and to our officers, there was no litigation that evolved out of the napalm experience. We do not really know what it cost us.

None of these products, the napalm or the agent orange, were shelf items that we had that we tried to sell to the Government. The situation was quite the contrary. These were instances where the Government came to us because we had the capability and the capacity to manufacture these products to a Government specification, and we performed these contracts in good faith.

In regard to the agent orange, once we became a Government contractor, the orders were continually increased, priorities were assigned, and we performed under the contract and provided the product, but it was largely at the expense of our commercial business at the time. This was a situation where the decisionmaking role was the Government's—everything from the decision to use agent orange to begin with and how it was to be used. The manufacturing specification was a Government specification. But even though that was the situation, in the litigation that we find ourselves in now today, if there was any negligence on the part of the Government on how this was used, the Government is not in the litigation to answer for its own negligence. But we are there without the Government, "we" being Dow and several other chemical companies.

We are not proposing that the United States assume the liability of Government contractors for their own negligence, but only that fundamental fairness prevail and that Government be held to account for whatever negligence it was involved in on its own. If there is negligence on both parts, then I believe that the draft that the NAM has proposed would provide for the concept of comparative negligence.

In the agent orange litigation, we now are faced with monumental costs to defend ourselves and, of course, we do not even find the United States in the courtroom, or at least they will not be there at the time the trial takes place. The United States is safely insulated by the Feres and Stencel doctrines, which I know you are familiar with. We firmly believe that there is no causative link between agent orange and the complaints that the plaintiffs have registered—the adverse health effects that they complain of. But we do not get to sit on the jury and the Government does not even have to appear at the trial.

I would like to just briefly read one or two sentences from my statement because I want to make sure I get it right. As to any future role of the Dow Chemical Co., under the present state of the law it should be noted that we have no contracts for research and development or production work on any chemical weapons. We would not seek that type of business. Were the President to call on us to say that Dow's production of chemical weapons is a matter vital to the national security, we then, and only then, would make a decision about our involvement as a Government contractor.

I believe in your opening remarks, Senator, you used the word, in referring to Mr. Brown's testimony, "discouraged," and I think that would probably very much apply to our position in regard to Government contracts.

We support the proposed comprehensive act and we think this would inure to the benefit of both the Government and the contracting community. It would provide a supply of viable Government contractors and potential contractors interested in that type of business, and it would also provide for some equity in either transferring or sharing liability where that should be the case.

This concludes my summary of my remarks, Mr. Chairman, and I would be glad to try to answer any questions you might have.

Senator GRASSLEY. You just spoke to one of the questions I was going to ask you. But for clarification and emphasis, I want to ask that you do not agree with the Department of Justice's analysis that there is not any need for this legislation because it is all cranked into the competitive bidding process and that there is plenty of competition for these contracts?

Mr. CAREY. Well, that is true; I would not agree to that. I think we are an example that refutes that very thought.

Senator GRASSLEY. Do you have any idea of how close you are to a resolution of the agent orange case?

Mr. CAREY. There could be a resolution as early as some time in probably the final part of 1983, and the reason is that the trial is scheduled to begin on June 27, 1983 in Judge Pratt's court in New York for a trial of the Government contractor defense issue. None of the other issues will be involved in that trial; it is a preliminary trial on that one issue.

Senator GRASSLEY. How much money have you spent in litigating that case?

Mr. CAREY. It is well up into seven figures; it is in the millions of dollars. I do not know the exact number, but it is extremely expensive.

Senator GRASSLEY. At what date in time did you first become aware that agent orange was toxic?

Mr. CAREY. I am sorry. I did not hear the last word.

Senator GRASSLEY. The last word I used was "toxic," but let me restate it again anyway. At what date in time did you first become aware that agent orange was toxic?

Mr. CAREY. I am not sure that I would agree that it is toxic. We became aware of a contaminant in agent orange in late 1964, I believe it was.

Senator GRASSLEY. And when did you notify the Government?

Mr. CAREY. The Government was notified—for one thing, the Government, as far as we know, was aware of this at either the same time or earlier than we were. But the Government was notified by Dow in connection with every batch we ever made.

Senator **Grassley**. Did the Government instruct Dow how much strength there should be to the defoliant that they asked you to provide them?

Mr. **Carey**. Yes. The specification was the Government specification, not ours.

Senator **Grassley**. And it met that specification?

Mr. **Carey**. I am sorry?

Senator **Grassley**. And it met that specification?

Mr. **Carey**. Yes, we met the specification in all cases.

Senator **Grassley**. So your answer to my question is through the normal specification process, they asked for a particular strength and got it?

Mr. **Carey**. Now, I want to make sure I understand you, Senator. The strength of the product?

Senator **Grassley**. Yes, to accomplish the goal that they wanted.

Mr. **Carey**. Yes, that is true.

Senator **Grassley**. Now, let me ask you a last, more general question. Does your insurance potentially cover your exposure?

Mr. **Carey**. I believe the answer to that would have to be no for a number of reasons. For one thing, the insurance itself is in dispute as to coverage.

Senator **Grassley**. Yes.

Mr. **Carey**. You have the problem of a deductible and then, of course, you have the problem of the sheer volume of the potential liability.

Senator **Grassley**. What is your deductible?

Mr. **Carey**. $150,000 per incident.

Senator **Grassley**. Well, that is all the questions I have of you. I thank you and your colleague very much for participating in this very important matter.

Mr. **Carey**. Thank you, Mr. chairman.

[The prepared statement of Mr. Carey follows:]

PREPARED STATEMENT OF CHARLES C. CAREY

> "A government contract must of necessity be different in nature from private undertakings. Nearly all government purchases and contracts are taken by open bidding; necessity exists to obtain the widest possible field of bidders in order to preserve tax revenues. Should bidders feel apprehensive that they might be sued for following specifications, either of two untoward results could ensue: (1) there would be no bids, or (2) bids would be inflated to take care of any potential liability. Public policy dictates that bidders who comply strictly with governmental specifications should be shielded from liability in any respect in which the product complies." Hunt v. Blasius, 55 Ill. App. 3d 14, 370 N.E.2d 617, 621-11 (1977), aff'd, 74 Ill. 2d 203, 384 N.E.2d 368 (1978).

My name is Charles Carey and I am on the legal staff of The Dow Chemical Company in Midland, Michigan. We appreciate this opportunity to express to the Subcommittee some of our views on the subject of indemnification of government contractors.

I

The purpose of any legislation which the United States Senate might consider on the subject of indemnification of government contractors should be to bring equity and fair treatment to an area where injustices now allowed to prevail are no longer permitted.

The relationships between a Government and its citizens have progressed immeasurably in many ways since the inception in ancient days of the doctrine of sovereign immunity when it was said that the "King can do no wrong." One notable example of our government recognizing its responsibilities to its citizens is the Federal Tort Claims Act of 1946, which provides for the bringing of a tort action against the United States under certain defined circumstances. Other steps have been taken in the past through various statutes to address the problem of indemnification by the government, albeit these have for the most part been confined to narrowly restricted situations. Examples are the Swine Flu Act of 1976, which provided for indemnification for liability incurred under the government's swine flu immunization program, and the Price-Anderson Act of 1976, which provides indemnity for government contractors for liability arising from a nuclear accident. Other statutes exist for other narrowly-defined risks. However, a piecemeal approach to this problem will never constitute a solution. Only comprehensive legislation applied in a fair and equitable manner can provide a comprehensive solution.

None of these particularized statutes addresses the general problem of the government contractor who, having fulfilled its obligations by performing under the contract, is faced with liability to a third party. These circumstances could exist even when a contractor has not been negligent in any way whatsoever, but the government has been negligent. In such a case the contractor may not be entitled to contribution or indemnification by the government.

This then is the area of inequity to which the Senate should turn. The problems are real--not academic or theoretical.

II

Rather than cover again the same points addressed by witnesses who appeared before this Committee on September 30, 1982, I will turn to some specific experiences of The Dow Chemical Company as a government contractor. Suffice to say at this time, that Dow fully supports the positions advanced by Messrs. McCloskey, Brown, Schwartz and Baird on September 30, 1982, as well as the proposed draft of a statute by the National Association of Manufacturers.

The Dow Chemical Company has had varied experience in serving our country as a government contractor. Operation of the United States government's nuclear weapons facility at Rocky Flats, Colorado, from 1952 to 1975, was a positive experience for both parties. In this instance, Dow was not left to assume obligations which were those of the government, largely due to the provisions of Public Law 85-804. The United States gained the benefit of Dow's expertise and we operated the plant under orders by the government.

Two other areas where Dow has assumed the role of government contractor have been in supplying napalm and Agent Orange to the United States for use by the military during the Vietnam War. Not much elaboration is needed to describe the problems which have plagued our company in the wake of these two attempts to be a good corporate citizen in time of our country's need. Neither one of these products was a "shelf item" that we were trying to sell to the United States. On the contrary, they were products specified by the United States which we, as a major chemical company, had the capacity and capability to produce. We did so, and performed according to the contracts which we entered into in good faith.

Government orders for the military defoliant Agent Orange were continually increased during the Vietnam War and "DO" ratings applied. We were compelled under a Department of Commerce directive to produce Agent Orange for the government and at the same time substantially lose our domestic market for commercial herbicides.

The Herbicide Orange experience is a case where the decision-making role was the government's. This included everything from the initial decision to use defoliants to begin with right down to the limitations on markings on the shipping drums. The government decided how to use it, where to use it, how much to use and specified how to make it. But if the government was negligent in any way, there is no recourse by those affected. In this real life case, the government controls the risk but the contractor supplies the product and ends up in the lawsuit.

We do not propose that the United States assume the liability of government contractors for their own negligence. But fundamental fairness would seem to require that the government assume responsibility for its own negligence.

In some situations it may be that the government and the contractor are each negligent. If so, the liability should be shared, as proposed in the N.A.M. draft bill.

In the case of napalm we found our plants picketed and numbers of death threats made against our employees, officers and directors. Our campus recruiters were subjected to all sorts of abuse, including forced confinement. Although no litigation arose from our role as a government contractor, the costs to Dow, including increased security costs, could probably never be accurately tallied.

In the case of Agent Orange, now we find ourselves alone, faced with billions of dollars of potential liability in what the presiding judge has called the "lawsuit of the millenium." Earlier witnesses have discussed the area of profits and prices in regard to government contracts. In our case, the government renegotiated this area so that what remains are the extremely high costs associated with defense of major litigation, with no end in sight. The United States government sits safely insulated from the litigation by the Feres and Stencel legal doctrines (discussed by earlier witnesses) which preclude not only recovery against the government by former military personnel, but similarly preclude any recovery through contribution and/or indemnification by government contractors, including The Dow Chemical Company. Although he should be admired for his frankness, small wonder that Secretary of Health and Human Services, Richard Schweiker, could announce in September of 1981 that the Air Force had "dumped" Agent

Orange in Vietnam on 41 occasions, some directly over or near U.S. air bases and other military installations. If any former military personnel are able to convince a jury that this exposure to Agent Orange is the cause of whatever illness they claim, Dow--not the United States may be held liable. We firmly believe that no causative link exists, but we don't get to sit on the jury. The United States doesn't even have to attend the trial.

As to any future role of The Dow Chemical Company under the present state of the law it should be noted that we have no contracts for Research and Development or production work on any chemical weapons. We would not seek that kind of business. Were the President to call on us to say that Dow's production of chemical weapons is a matter vital to the National security, we then, and only then, would we make a decision about our involvement as a government contractor.

Conclusions and Recommendations

The Dow Chemical Company fully supports the version of H.R. 1504 with the suggested revisions of the National Association of Manufacturers. The enactment by both arms of the legislative branch of the United States government of this proposed comprehensive act, as revised, would benefit both government contractors and the citizens of the United States in several ways.

Contractors would be able to bid on government contracts based on their realistic costs and not on the basis of some inflated speculations related tc possible catastrophic losses. This would ensure more competitive bidding on government business and assure the availability of a larger group of potential contractors willing to engage in this activity. This is not to say that contractors should not be held responsible for their own fraud, misrepresentation or willful misconduct. But a mechanism for the legitimate transfer to or sharing of liability by the government where appropriate is long overdue. We believe that the McClory bill, with the revisions proposed by the National Association of Manufacturers should be enacted by the United States Senate.

Senator **Grassley**. Our final two witnesses are from the American Bar Association. Mr. Robert Wallick is chairman of the section of public contract law, and he is accompanied by Mr. Lawrence Stich, who is chairman of the insurance and indemnification committee.

Would you gentlemen proceed according to how you had previously planned to participate? Whichever one of you wants to proceed first, I would invite you to do that.

STATEMENT OF ROBERT D. WALLICK, CHAIRMAN, SECTION OF PUBLIC CONTRACT LAW, ACCOMPANIED BY LAWRENCE P. STICH, CHAIRMAN, INSURANCE AND INDEMNIFICATION COMMITTEE, AMERICAN BAR ASSOCIATION

Mr. **Wallick**. Thank you, Senator. I am Robert Wallick, the chairman of the section of public contract law, and Mr. Stich is the chairman of our committee on insurance and indemnification. I believe I will give our prepared remarks, and probably most of any questions you might have, I will let Mr. Stich have the pleasure of fielding for us.

We will try not to be repetitive of what has been said by prior witnesses today. We should make it clear that the views that Mr. Stich and I stress today are the views of the section of public contract law of the American Bar Association and do not necessarily represent those of the association itself.

We have attached to our prepared statement a very detailed analysis of the question of indemnification of Government contractors, which is an official position paper of our section, and I would like to direct the committee's attention to that particular document, which is a very thorough analysis of what our section views as a very critical problem. Let me say one other threshold comment. Our section's council, which is the governing body of our section, includes a crosssection of Government, corporate and private practitioners in the law, and the views that are expressed by us today have a broad base of support, I believe, across essentially the whole section of public contract law.

We view the indemnification problem as being in two general categories. The first is the question of a catastrophic accident, and the second deals with the agent orange problem—a problem of the liability exposure of contractors who perform in accordance with Government specs, have no negligence or fault of their own, and who have to stand at the block in court perhaps for the problems generated by the Government specifications.

On page 2 of our prepared statement, we point out some of the past history, and the very prestigious Government Procurement Commission which was referenced by a prior witness—its conclusions of need for indemnification in both areas, the catastrophic insurance area and the agent orange area.

PRECEDENT FOR INDEMNIFICATION

We also point out that in the Price-Anderson Act and in two other instances, there is precedent for providing indemnification. We speak today in two senses. We believe that in a matter of simple fairness, this should be accomplished. There are many instances in Government contracts where contract clauses and contract provisions are directed at assuring fairness in the relationship between the Government and the contractor and third parties. We believe that what we ask for is a matter of simple fairness.

We also believe that it is in the best interests of the Government, of the contractors, and certainly of the third parties that indemnification be provided.

In terms of the catastrophic insurance situation, it is unfortunately true that in most instances, if you fall outside the Price-Anderson Act, there is not indemnification provided by the Federal Government. We have been lucky in this country that there have not been large, catastrophic accidents, but that will not continue, we fear, and one of these days there will be one that has not been addressed realistically in advance so that it can be accommodated to the satisfaction of all concerned—those who are injured, the contractor involved, and the Government—in a reasonable, quick, and prompt way. It is a situation that because this country has been fortunate, it has not been put on the front burner. But we fear that it will, and our remarks address that problem.

As far as the agent orange situation is concerned, we believe that our experience has been that this is not a coverage that is adequately insured by most contractors. It is a coverage that contractors should not be asked to bear as a matter of simple fairness where the Government is the party at fault.

We have cited the case law history in our address, and others have spoken to it, which has arrived at this unfortunate result of the Government not being responsible where it is at fault and the contractor having to bear that responsibility. I do want to address the committee's attention, beginning on page 5, to what are the specific recommendations that our section has for any statute that deals with this very important issue of indemnification.

GENERAL APPLICABILITY ROLE ADVISED

We believe, first, that the statute should be of general applicability and not limited to particular agency activities or types of risk. We would make an exception for the Price-Anderson Act, which has worked well, and believe that it might be a model for any initiative by this committee. The statute should be as self-executing as is reasonably possible. By that we mean that there should not be a whole lot of gray area as to whether it applies or not. It has been our recommendation that in the case of the catastrophic accident, this be triggered by a Presidential determination that an accident has occurred.

We also believe that the definition of a catastrophe should be based upon the probability that damages in excess of a stated amount are likely to have occurred as a result of an accident. The present situation under Public Law 85–804 is an unfortunate one in which agencies are asked in advance to declare that some activity of theirs is unusually hazardous. This has not worked out practically. We believe the kind of a definition that we propose is more practical.

And then, third, indemnification should flow to all program participants, be they contractors, licensees or grantees, or their subcontractors, sublicensees or subcontractees, of any tier. The whole gamut of relationships needs to be addressed in any legislation.

Fourth, for the catastrophic accident situation, indemnification should be provided if the contractor can show that its liability is beyond the insurance coverage which is reasonably and practically available. For this purpose, the Federal agencies should be allowed discretion on the extent of insurance and private financial protection to be provided. There is a range of insurance protection in this regard that insurance companies can and do adequately provide. We are only talking about what is reasonably required beyond what might be reasonably obtainable in that regard.

Fifth, for the catastrophic accident situation, the statute should provide for prompt victim relief. That is one of the dangers in the present situation. Interim relief and waiver of defenses might be considered and could appropriately, in our view, be incorporated into such a statute.

Sixth, in addition to providing indemnification for catastrophic accidents, the statute should cover accidents where the contractor has complied with performance requirements of its contract and the Government was primarily responsible for the accident. In such noncatastrophic cases, the statute could establish a comparative responsibility basis for allocating the financial burden of accident victims.

This concludes our prepared remarks today, Senator. We would welcome any questions which the committee might have.

Senator GRASSLEY. And you are just submitting your portion of this in what we have here for the record, right?

Mr. STICH. Yes, Senator. I think you can take it that Mr. Wallick and I are kind of a duo. We both represent the public contracts section.

Senator GRASSLEY. My questions would be directed to both or either one of you. At the outset of your testimony, you state that your views and recommendations have not been approved by the ABA or its board of governors. In March of 1981 when Mr. Heistand and Mr. Stich appeared before the House Subcommittee on Administrative Law and Government Relations, their testimony was prefaced with the same caveat.

Would you tell us a little bit more about the process of obtaining the opinion that represents the entire association and when that opinion, if at all, would be forthcoming?

Mr. WALLICK. Yes. In the ABA process, there is a process by which sections such as ours, in substantive areas, can give their views. We are here under that process that allows a section, with our almost 4,000 members, to come forward and we are permitted to give our views. That requires a large clearance process through the ABA.

SPECIAL COMMITTEE APPOINTED

On the larger question of product liability insurance, as opposed to this question of indemnification, the president of the American Bar Association has appointed a special committee of five members who are deliberating and will shortly come out with a report with certain recommendations to the president and the association as to what the association's views should be.

That report, as it may be subsequently amended, plus others' views, will be presented to the governing body, or at least we expect it to be presented to the governing body of the American Bar Association, which is its house of delegates, which represents delegates from the various States and certain other bodies. That body will vote on the whole question and establish an ABA position, we believe, in February of next year.

Mr. STICH. Senator, I would like to also add that, generally, when you have an ABA section coming before a subcommittee of this type, it would usually be presenting, hopefully, an informed and wise view on a specialized area of the law, which is the case with the public contract section in this instance.

Senator GRASSLEY. On another point, is the development of a widely accepted Government contract defense likely?

Mr. STICH. I think it is most unlikely. If you are a scholar of product liability law in general, looking at the issue cosmically, you can see that every one of the 51 or more jurisdictions in the country have their own version of what constitutes product liability law.

Now, there are some common threads, like strict liability in tort which is followed by most of the jurisdictions today. But the warp and the woof of what constitutes the various aspects or concepts in product liability law does vary widely from jurisdiction to jurisdiction.

To my knowledge, recognition of a Government contract defense is a minority position today, and each jurisdiction that has embraced the concept of this defense has embraced a somewhat different form of it. Indeed, in New York State, where Judge Pratt sits in Federal court on the agent orange case, he enunciated a very thoughtful version of that defense in re *"Agent Orange" Product Liability Litigation,* 534 F. Supp. 1046 (1982). But in that same State, a State court in the *Casabianca* case, enunciated another version of it. So, even in the same State, you have two courts enunciating differing versions of the same defense.

The prospect that this defense will be embraced in any kind of a consensus manner across all the jurisdictions, I think, is just so remote that it will not happen. You will have to legislate it if we are going to get any uniformity on such a point.

Senator GRASSLEY. Could you give us an idea of how the Anti-Deficiency Act applies to contracts to which the parties have agreed that insurance cannot be obtained?

Mr. WALLICK. I will ask Mr. Stich, our authority on the Anti-Deficiency Act, to speak on that.

Mr. STICH. That is an extremely difficult question, Senator. I have debated it, thought about it, and discussed it for many, many moons. But let us see; I'll take a crack at it, and if I fall short, I will try to improve my answer in writing later.

The Anti-Deficiency Act says to the buying agencies of the Government, "Thou shalt not obligate the Government unless you have money appropriated by Congress to pay the obligation." Now, that is a pretty clean concept. Then it goes on to say in a subsequent paragraph, "Unless you have a statute that authorizes you not to observe this prohibition."

Now, when you look at the issue of contractor indemnification, you have a number of authorities which the people from the Justice Department, DOD, and most of the witnesses here have alluded to, title 10, United States Code, section 2354, Public Law 85-804, and indeed, the Price-Anderson Act. You also have a clause which I think prompted the question—the one that the Comptroller General has issued in his May 3 opinion on (GAO decisions No. B-201072, May 3, 1982).

Some may argue whether indemnification agreements under any of these statutory authorities comes within that exception of the Anti-Deficiency Act or not. I think the argument is pretty strong to the point of being dispositive, that indemnification agreements do not violate the act when you are dealing with title 10 United States Code, section 2354 or Public Law 85-804. In these cases it seems clear to me, and I believe to the GAO as well, that these statutory authorities permit indemnification under the "except as otherwise authorized buy law" exception contained in the Anti-Deficiencies Act. However, in the case of the clause that was the subject of the Comptroller General's opinion back in May, the argument is not that clear. The clause is not directly mandated by statute. However, the clause has been around for 40 years. It has been a part of either the armed services procurement regulations or the defense acquisition regulations for that length of time. Indeed, it was last amended by the Department of Defense back in 1966 when they added express language saying that the clause could be used without regard to the limitation of funds or other funding limitations applicable to the contract in which the clause was placed.

The clause was also stipulated to be a boiler plate clause for incorporation into all of what we call cost reimbursement contracts let by the civilian agencies as well as the Department of Defense. It is against this history that the Comptroller General issued its May 3 opinion—an opinion which must be read with great care even if you are a proponent of that opinion, which I am not.

But assuming that one agrees with the thinking behind the opinion, you still would have to struggle with the way the opinion was stated. I do not think that the committee wishes to examine all the permutations that might be gone through in order to examine all the arguments and practical difficulties engendered by that opinion. Suffice it to say that I believe at this point, as a result of meeting with the Comptroller General--attended by Mr. Wallick, myself, and a number of people who are regarded as experts in the field—that the Comptroller General may be willing to reexamine the implications of the May 3 decision based upon issues that are present in that decision and should, in my view, have been addressed at the time the decision was prepared.

I guess, my best answer to your question, Senator, is that in a particular case where you are not dealing with express statutory basis for indemnification, the question of the Anti-Deficiency Act gets very fuzzy. One could argue, for example, that the defense acquisition regulation is a matter of law itself; that once DOD, going through its established process, enunciates a regulation under which it is going to operate, that regulation has the force and effect of law. One could say that proper promulgation of a regulation mandating the use of an indemnification clause is persuasive and dispositive of the issue as far as the Anti-Deficiency Act is concerned.

However, after you finish this analysis, and a number of others, you then must ask yourself this question: Well, OK, Mr. Lawyer, you have given me the benefit of all these words. What if there is not any money to pay the indemnification left in the agency appropriation? You may be right back to where you started from unless there is some legal way to overcome this impass, as for example, a conclusion that such a situation may be brought within and considered under the general appropriations for payment of judgments against the United States as established in title 31, United States Code, section 724a.

Now, if certainty is something that you really must have in order to feel good, such a prospect is not very comforting. But I think the world is constructed of a lot of uncertainties. We would like to have these issues resolved, and hopefully we can. But in the scheme of things, this particular issue is a relatively small problem compared to the one we are here to address, the overall catastrophic liability and indemnification issue.

Hopefully, whatever legislation you may decide to pass will express itself with sufficient clarity to make it certain that the requirements of the Anti-Deficiency Act are indeed met; that we will not have to tangle ourselves up in this problem any further.

Senator GRASSLEY. Has there traditionally been an overall dollar limit imposed on draft legislation?

Mr. STICH. Please say it again, sir?

Senator GRASSLEY. Has there traditionally been an overall dollar limit imposed on draft legislation?

Mr. STICH. Yes, such limits have been suggested until the last few years. I think I know, why that is the case, and it is not the product of any great cerebration; no great thought went into it. It just so happens that when people drafted the Price-Anderson Act back in the mid 1950's, they came up with the number of $560 million as a total liability limit. How they did that has been explained to one. It ultimately boiled down to the fact that the Congress concluded that $500 million was the total amount of risk that the Government thought was appropriate for it to assume and the extra $60 million could be underwritten by a number of insurance pools that were put together to underwrite the nuclear energy risks covered by that statute.

As later draftsmen came along in the 1960's and indeed into the 1970's, as far as I can determine for want of any better figure, they latched on to the $60 million figure or the $500 million figure utilized by the drafters of Price-Anderson, and used one number as the other in drafting proposals to cover other, potentially catastrophic risks.

I have talked to almost everybody who was involved in drafting those statutes over the years—and I have been working at this problem for 15 or more years—and that appears to be the way it happened. Most of the proposed indemnification bills have had some such limitation until, I would say, the second draft of the Office of Federal Procurement Policy back in 1977. This OFPP draft abandoned the overall limitation. Today, I think the concept of putting a maximum liability limitation into a statute of this type would be ill advised, Senator. I do not think it would really be a good thing to do at this time. Legislation resulting in accident victims going uncompensated would be hard to get through today. Frankly, I do not believe that the Congress would pass the Price-Anderson Act, with a $560 million total liability limit if it were being considered today.

Senator **Grassley**. Well, I thank you specifically as representatives of the ABA. I want to thank you, but I also want to say that that completes our witness list. I am very pleased with the record that we have formed here today, and I thank all of our distinguished witnesses totally.

Mr. **Stich**. I would like to say one more helpful thing, Senator. A wise man knows when to shut up, but I think it would be helpful to say something more.

You have raised the question of insurance number of times during the course of these hearings, and there is one aspect of liability insurance which I think needs to be focused on by anybody thinking about legislation covering Government contractors liability risks, and that is that the insurance industry just does not write long-term product liability insurance. It is underwritten on an annual basis.

When a Government contractor is looking at a piece of business with the Government, there is usually no practical way that he can crank his insurance costs into his contract price or indeed do anything but speculate as to what the costs of his insurance may ultimately be. He does not know how long his product is going to be in use, and as a matter of fact, he does not even know if insurance is going to be available 5 years or 10 years from now for that particular risk.

So, when we are thinking about insurance, we must also think about the time span involved in amortizing the costs of externalizing the risk via insurance, and if you lose sight of that, you are liable to get confused. This inability to determine the cost of handling the risk by way of insurance is, I think, an important aspect of the consideration of the problem of indemnification.

So, when people from the Justice Department or anywhere else come around and say, "Hey, you can insure this," well, today you may be able to, but 15 or 10 years from now when the risk is most acute, you may not be able to.

Mr. **Wallick**. And the key to that, Senator, is the fact that typically in the policy, it is the occurrence of the accident that triggers the liability, so that you could have a product out for 10 years—and indeed there are cases where you were insured for the first 9 and in the 10th year when the accident happened, you would not have it. That is what Mr. Stich is addressing.

[The prepared statement and report submitted by Mr. Wallick follows:]

PREPARED STATEMENT OF ROBERT D. WALLICK

We appreciate this opportunity to present the views of the Section of Public Contract Law of the American Bar Association on the need to indemnify government contractors and grantees against certain risks of accidents affecting third parties. This statement has not been approved by the American Bar Association or its Board of Governors and does not necessarily represent their position.

I am Robert D. Wallick, Esquire, Chairman of the ABA's Section of Public Contract Law. With me is Lawrence Stich, Chairman of the Section's Insurance and Indemnification Committee We have attached a detailed Report, with recommendations, which our Section presented earlier this fall to the Office of Federal Procurement Policy.

There is pressing need, we suggest, for legislative and executive action to provide indemnification to contractors and grantees against risks of two categories of accidents, catastrophic and those for which the government is primarily responsible.

In 1963, the Legislative Drafting Research Fund of Columbia University completed a thorough study and report on "Catastrophic Accidents in Government Programs," concluding that,

> We have found that under present law, there is no assurance of compensation to the victims of a catastrophic accident, at the same time contractors are exposed to the dangers of devastating liabilities with no sure means of guarding against them.

The situation remains essentially the same today.

Nine years later, in 1972, the prestigious Commission on Government Procurement recommended legislation,

> . . . to assure prompt and adequate compensation for catastrophic accidents occurring in connection with Government programs . . .

and legislation,

> . . . to provide Government indemnification, above the limit of available insurance, of

> contractors for liability for damage arising from a catastrophic accident occurring in connection with a Government program.

Those recommendations remain unfulfilled.

There are precedents for general legislation of the type recommended by the Commission. The Price-Anderson Act, 41 U.S.C. 2210, has established government indemnification for liability arising from nuclear incidents. Indemnification was provided in the administration of swine flu vaccine by 42 U.S.C. 201. Government contractors may be indemnified under 10 U.S.C. 2354 for third party claims arising out of "direct performance" of research and development contracts with military departments of the United States, if the claim arises from "unusually hazardous risks." Unfortunately each of those statutes is limited to a particular type of risk and include other restrictions.

The only statute with a potentially broad reach has been Public Law 85-804, 50 U.S.C. 1431-1435. However, as explained in the attached memo, this statute in practice has been of extremely limited practical utility. Implementing Executive Orders 10789 and 11610 have limited indemnifications under Pub. L. 85-804 to risks defined as "unusually hazardous." Few are the situations where an Executive Agency is willing to place that label on its activities. For this and other reasons, Pub. L. 85-804 has been ineffective. Legislation is urgently needed to assure adequate compensation to the public and appropriate indemnification to contractors for catastrophic accidents under government programs.

Our second area of concern today, risk of an accident for which the Government is primarily responsible, also is an imperative. Two bills to remedy injustices in this area were introduced during recent sessions. H.R. 5351 was placed before the 96th Congress by Congressman Gudger with fourteen co-sponsors. In the 97th Congress, Chairman Danielson and Congressman McClory, joined by thirteen other members, introduced H.R. 1504. These bills were designed to prevent reoccurrence of injustices perceived in Stencel v. U.S., 431 U.S. 666 (1977) and Henry v. Bell Textron, 557 F.2d 1163 (4th Cir. 1978). In the later case, the contractor had delivered its product to the Government a full ten years before the accident which gave rise to its liability. The product, a Bell UH1H helicopter, had been delivered to the Federal Government in 1966, had served two combat tours of duty in Vietnam, had been overhauled on two occasions, and had been modified by normal maintenance to the extent that virtually every relevant part had been replaced at least twice since its manufacture. The evidence also suggested that the aircraft had incurred battle damage in Vietnam on at least one occasion. The accident involving this helicopter occurred early in 1976, and resulted in the death of the two pilots on board. At the time of the accident, the helicopter was assigned to the Virginia Army National Guard, the the two deceased pilots were performing training duty as members of the Guard.

The opinion of Judge Haynsworth in that case, the evidence and the briefs on appeal, indicate that Bell Textron was far less blameworthy for the accident than the government. Judge Haynsworth noted that the government "defendants were more responsible for the crash than Bell Textron." In holding against the contractor, Judge Haynsworth further noted that "Bell Textron is placed in a very difficult position by the expanding doctrines of products liability and the rleatively inflexible doctrines of sovereign immunity and Eleventh amendment immunity, but unfortunately for it, the law is clearly against it."

Numerous cases have been decided against government contractor defendants which reinforce the concern stated so succinctly by Judge Haynsworth in Bell Textron. See Boeing Airplane Co. v. Brown, 291 F.2d 210 (9th Cir., 1961), Foster v. Day and Zimmerman, 502 F.2d 867 (8th Cir. 1974); Challoner v. Day and Zimmerman, 512 F.2d 77 (5th Cir. 1975), judgment vacated and remanded for further proceedings, 423 U.S. 3 (1976); Barr v.

Brezina Construction Co., 464 F.2d 1141 (10th Cir. 1972); Stencel Aero Engineering Corporation v. U.S., supra. The doctrine of sovereign immunity excuses the Government from all tort liabilities, except those encompassed by the Federal Tort Claims Act (or other special enabling statutes or treaty). Under that Act, the Government cannot be held liable under a theory of absolute or strict liability for ultra hazardous activities. However, the producing contractor has no such protection. For this and other reasons discussed in the attached memo, the contractor may be held liable for an accident, even though he produced to government specification and is essentially blameless. This is a particularly onerous risk for smaller contractors with limited insurance protection.

We recommend a new statute containing the following features:

1. The statute should be of general applicability and not limited to particular agency activities or types of risk. (The one exception to this might be to leave undistrubed the Price-Anderson Act. It appears to be working satisfactorily. Indeed, that Act might well serve as a point of departure for the new legislation, thus enhancing the likelihood of a consistent national policy.)

2. The statute should be as self-executing as is reasonably possible. (In the case of a catastrophic accident, a Presidential determination that such an accident has occurred should be sufficient to trigger indemnification. The definition of catastrophe should be based upon the probability that damages in excess of a stated amount are likely to have occurred as a result of the accident.)

3. Indemnification should flow to all program participants, be they contractors, licensees, or grantees, or their subcontractors, sublicensees, or subgrantees of any tier.

4. For the catastrophic accident situation, indemni-

fication should be provided if the contractor can show that its liability is beyond the insurance coverage which is reasonably and practically available. For this purpose, the Federal agency should be allowed discretion on the extent of insurance and private financial protection to be provided.

5. For the catastrophic accident situation, the statute should provide for prompt victim relief. (Interim relief and waiver of defenses might be considered and could, appropriately in our view, be incorporated into such a statute.)

6. In addition to providing indemnification for catastrophic accidents, the statute should provide for accidents where the contractor has complied with performance requirements of its contract and the Government was primarily responsible for the accident. (In such non-catastrophe cases, the statute could establish a comparative responsibility basis for allocating the financial burdens of accident victim compensation.)

This concludes our prepared remarks. We would welcome any questions which the Committee might have.

AMERICAN BAR ASSOCIATION

WRITER'S ADDRESS AND TELEPHONE

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September 27, 1982

Honorable Donald E. Sowle
Administrator
Office of Federal Procurement Policy
Suite 9001
New Executive Office Building
Washington, D. C. 20503

Re: Indemnification of Government Contractors

Dear Mr. Sowle:

We enclose a report with recommendations (pages 18-19) of the Section of Public Contract Law concerning a broader indemnification of government contractors and possible implementing legislation. We would appreciate an opportunity to present our views and recommendations to you.

These views and recommendations are being presented by the Section of Public Contract Law and have not been approved by the House of Delegates or the Board of Directors of the ABA and should not be construed as representing the position of the ABA.

Sincerely,

/s/

Robert D. Wallick
Chairman

RDW:eeh
Enclosure

Report and Recommendations
Insurance and Indemnification Committee

BACKGROUND AND PRIOR ANALYSIS

Commission on Government Procurement Recommendations

Ten years have passed since the Commission on Government Procurement published its Report containing its recommendations that legislation be passed "... to assure prompt and adequate compensation for victims of catastrophic accidents occuring in connection with Government programs." (Recommendation H-4) and "... to provide Government indemnification, above the limit of available insurance, of contractors for liability for damage arising from a catastrophic accident occurring in connection with a Government program." (Recommendation H-5). 1/ In reaching these recommendations, the Commission concluded, inter alia, that the then "existing laws of the United States are inadequate to cope with the two basic problems which would arise from a domestic catastrophic accident resulting from a Government program: (1) the need for a means to provide prompt financial assistance to victims of the accident; and (2) the need to shield contractors and subcontractors from uninsurable risks."2/

Other Studies

The concern over Government contractor liability was by no means a new issue in the early 1970's when Study Group No. 8 studied the problem and made its report and recommendations which were subsequently adopted and endorsed by the Commission in its Official Report. In the early 1960's, the matter had generated such concern that the National Security Industrial Association sponsored a study by the Legislative Drafting Research Fund of Columbia University which in 1963 published a thorough review, report, and set of recommendations. This document, entitled, "Catastrophic Accidents in Government Programs" (The "Columbia Study") found that damages from accidents in Government programs could exceed by many times the damages caused in the Texas City disaster of 1947, and that claims conceivably could exceed $500,000,000.00. This estimate was made in 1963 dollars and was based upon the habits of juries and courts up to that time. Today, inflation and the trend toward larger and larger verdicts would doubtless increase that figure greatly. Another study by the Bar of the City of New York, reflected in a report published in 1968 3/ and the Report of Hearings by the Military Operations Subcommittee of the House Military Operations Committee, in 1963, also supported the findings of the Columbia Study.4/

Subsequent to the Procurement Commission Report, an intragovernmental Task Group was established to draft appropriate legislation which, if enacted, would carry out the quoted recommendations. The report and draft bill proposed by this Task Group was distributed for comment by memorandum of the Office of Federal Procurement Policy (OFPP) dated March 9, 1977.

In its Report, which again briefly addressed the status of existing legislation, regulations, and procedures, the Task Group stated that it, too, favored the recommendations of the Procurement Commission "because (the Task Group) agrees with the Commission that even though catastrophes of the magnitude contemplated by the Commission are rare...there should be a ready authority to provide aid to victims at the earliest time. Even though Congress might provide such authority after a disaster occurs, it seems preferable ...that this authority be provided in advance...".5/

Any review of effort and attention given on this subject would be incomplete if it failed to include reference to the work sponsored by the Aerospace Industries Association. A group within the AIA worked for many years to draft and secure passage of legislation which would alleviate the public and contractor's exposures resulting from catastrophes occurring in Federal Government programs. This group produced a carefully considered draft bill which they submitted to the Government Procurement Commission's Study Group No. 8 in February 1972, and this AIA draft bill appears to be the antecedent to the bill drafted by the Government Task Group in 1977.

Prior Draft Bills Compared

Both the AIA and the Task Group bills were quite comprehensive. They provided interim payments for restoration of essential services and medical expenses of victims, effected tort law reform by requiring waiver of defenses by contractors against indemnified claims, defined "catastrophe" in terms of estimated total damages, and established a maximum total liability limit of $500 million for all claims resulting from a catastrophe. The AIA bill was semi-self executing in that indemnification was to be provided upon a finding by the President that a catastrophe, as defined in the bill, had occurred. However, the Task Group bill required that indemnification would be provided on a contract-by-contract basis via an "indemnification agreement" to be made part of the contract. The AIA bill limited indemnification to "public liability" arising out of or resulting from a "catastrophic indident" which the "President determines to have resulted from any activity of a potentially hazardous nature conducted by the United States, or under a contract or grant...". The phrase "activity of a potentially hazardous nature" was defined to mean activities involving "(1) ...aircraft, spacecraft, watercraft, missiles (and ground control equipment, guidance systems and propulsion systems for any of the foregoing), radar equipment, rocket fuels, munitions, explosives, or substances capable of detonating with explosive force; or (2) any other activities which the President determines to be of a hazardous nature (i) by regulation in advance of or occurrence or (ii) by proclamation...after an occurrence." The Task Group bill, however, required that the "catastrophic occurrence" arise from "unusually hazardous activity."

While OFPP solicited review and comments on the Task Group bill, it was apparently not officially embraced by OFPP, since in early 1978 the OFPP informally released for comments a new draft bill which omitted waiver of defenses (tort reform) and the maximum liability limitation. This 1978 draft bill also abandoned the "unusually hazardous activity" requirement and substituted instead a requirement that the provisions of the bill would apply only to contracts wherein the head of the contracting agency determined that the "Cumulative amount of liability...may exceed the higher of either $60 million or the amount of such insurance as may be required or approved under or for the contract...". As with the earlier Task Group bill, this 1978 OFPP bill would provide coverage only on a contract-by-contract specific agreement basis.

Both the Task Group and the 1978 OFPP draft bills were circulated for comment within and outside the Federal Government. Industry comments were rendered by the Council of Defense and Space Industry Associations by a letter dated May 17, 1977, with regard to the Task Group bill, and by letter dated March 10, 1978, with regard to the 1978 OFPP bill. It is noteworthy that while both the AIA and the Task Group draft bills indemnified "any legal liability" arising out of the defined activity or incident, the 1978 OFPP bill covered only liability for death, bodily harm or loss of or damage to property. Thus claims for economic loss were not covered by the 1978 OFPP bill.

EXISTING LEGISLATION

Congressional attention has from time to time been focussed on portions of the overall problem, as witnessed by hearings cited in note 4, supra, and the enactment and amendment of legislation providing government indemnification of liability arising from nuclear incidents[6/] and the administration of swine flu vaccine.[7/] In addition, government contractors may also be indemnified by the Government under 10 U.S.C. 2354 for third-party claims arising out of "direct performance" of research and development contracts with the military departments of the United States, if the claim arises from risks defined as "unusually hazardous." Each of these statutes have clear subject matter limitations which constrain their use to the specified areas of endeavor. The only statute which establishes other than specific subject matter authority for Government indemnification of contractors is Public Law 85-804, 50 U.S.C. 1431-1435, which was passed in August 1958 to enact into permanent law much of the authority contained in Title II of the First War Powers Act of 1941, which expired June 30, 1958. As indicated in the legislative history of Public Law 85-804,[8] the limitations of 10 U.S.C. 2354, which restrict the use of that statute to military research and development rather than to production contracts, was viewed as necessitating the reenactment of the prior law authorizing the indemnification of production related risks. However, there have been a number of impediments to indemnification authorized by this statute, including an Executive Order restriction effectively limiting the use of this authority to risks defined as "unusually hazardous."[9] As we shall discuss later, this particular limitation on the use of the authority created by this statute has severely restricted its use.[10]

Federal Tort Claims Act

Ironically, the U.S. Government itself appears to be judgment proof against claims arising out of ultrahazardous activity if the plaintiff cannot prove negligence. It is now firmly established that the Federal Tort Claims Act[11] does not authorize suit against the Government for such claims. This conclusion was anticipated in what was apparently dicta in Dalehite v. U.S. 346 U.S. 15, 45, 97 L Ed. 1427, 1445, 73 S. Ct. 956 (1953) and was confirmed in the more recent case of Laird v. Nelms, 406, U. S. 797, 32 L. Ed. 2d 499, 92 S. Ct. 1889 (1972). Whether or not Dalehite hinged upon the discretionary act exemption or simply held "that the Federal Tort Claims Act did not authorize suit against the Government on claims based upon strict liability for ultrahazardous activity" (Nelms at 802) is now moot. The Government cannot be held liable under the Act on a theory of absolute or strict liability for ultrahazardous activities. Even if a claimant could avoid these precedents by proving that his injuries were caused by Government negligence, he still must overcome the obstacle of the "discretionary function" exclusion which exempts such acts from incurring Government liability under the Federal Tort Claims Act.[12] Confronting such difficulties in a suit against the Government, it is only prudent to anticipate that damaged claimants would press litigation against an involved contractor under a number of well established and convenient theories, such as strict liability in tort, breach of implied warranty, and, of course, negligence--all of which have been used successfully and repeatedly by third party plaintiffs in securing liability judgments against Federal Government contractors. We will address some of these specific cases later.

Treaty

To be fully accurate, however, we must point out that the immunity of the United States from liability on "no-fault" theories is, ironically, limited: foreigners injured by falling U.S. space debris may collect from Uncle Sam without any showing of fault or negligence. The U.S. Government has entered into a multilateral treaty[13/] under which the launching government assumed absolute liability for all damage to foreign governments and nationals caused by its falling space debris. Hence, though the United States would, by treaty, compensate foreigners who may be damaged by falling space debris, absent proof of negligence the U.S. Government would be immune from liability for such damage to its own citizens.

RECENT LEGISLATIVE EFFORT

Two bills have been introduced in recent years which were intended to remedy the injustice perceived in the application of strict product liability to Government contractors. H.R. 5351 was submitted to the 96th Congress by Congressman Lamar Gudger and was co-sponsored by fourteen other Members. Hearings were held on July 21, 1980 by the Judiciary Committee, Subcommittee on Administrative Law and Governmental Relations. The Public Contracts Section of the American Bar Association, by a letter dated March 22, 1980, had submitted comments in support of the bill and recommended a number of changes to it.

In the 97th Congress, Chairman Danielson and Congressman McClory were joined by thirteen co-sponsors in submitting H.R. 1504 which is pending before the same Subcommittee. H.R. 1504 reflected most of the recommendations made by the Public Contracts Section with respect to the predecessor bill. Hearings were held on H.R. 1504 on March 19, 1981, and the Section Chairman and the Chairman of the Section Committee on Insurance and Indemnification appeared and testified on behalf of the Section in support of this bill.

Both H.R. 5351, as well as H.R. 1504, were directed at remedying the inequities of holding a Government Contractor liable for damages even though the contractor was not at fault and had complied with the requirements of the Government Contract. In other words, these bills were designed to prevent the reoccurrance of the injustice perceived in the results exemplified in the Stencel v. U.S.[14/] and the Henry v. Bell Textron[15/] cases, discussed below. Both bills provided that contractors meeting the criteria established in the bill would be indemnified by the United States Government. While an accident which would be indemnified by H.R. 1504 need not reach the magnitude of a "catastrophe," as contemplated ty the Procurement Commission's Study and Recommendations quoted above, nonetheless, in our view, the issue of fundamental fairness posed by these cases leads us to state our continued support for such legislation as an adjunct to legislation which would effectively handle the catastrophic situation.

INADEQUACY OF P.L. 85-804

The irony, already alluded to, that the Federal Government is immune from suit on strict liability theories unless the claimant is a foreigner damaged by falling U.S. space debris, is compounded by the fact that Federal Agencies are reluctant to use existing authority to indemnify against claims beyond reasonably available insurance. For example, Public Law 85-804, 50 U.S.C. 1431-1435, referred to supra, as implemented by Executive Orders 10789, Nov. 14, 1958, 23 Fed. Reg. 8897 and 11610, July 22, 1971, 36 Fed. Reg. 13755, gives NASA the authority to contractually indemnify a contractor for third party claims resulting from efforts under a NASA contract. However, indicative of the problems involved in utilizing this authority is NASA's established policy against doing so. This policy is expressly set forth in its procurement regulations. NASA PR 10.350 states:

> "...It is NASA's firm policy not to use the authority contained in Public Law 85-804 (50 U.S.C. 1431-1435). It is also NASA's policy not to indemnify contractors and subcontractors at some time in the future, if and when NASA should be authorized by subsequently enacted legislation to grant such indemnification, or if and when NASA might promulgate for general use an indemnification clause within the limits of existing legal authority. However, if indemnification authority is subsequently provided to NASA by legislation, NASA will do whatever is permitted by the statute and other available authority to apply its provisions so that all elements of industry similarly situated are treated in the same fashion and that a proper assumption of risks is undertaken by the government, whether such risks arise under contracts in effect or are contemplated in any new contract."

The reasons for NASA's across-the-board decision not to use the authority created by P.L. 85-804 are not expressly stated in NASA's externally released regulations. It is understandable, however, that agencies such as NASA,[16] which have been authorized to indemnify contractors under P.L. 85-804 have been reluctant to exercise this authority, since to do so, they must declare, officially, that their programs involve "unusually hazardous" risks. As pointed out above, government indemnification of contractors under this statute is governed by Executive Orders 10789 and

11610. Executive Order 11610 in paragraph 1A(a) permits indemnification beyond appropriated funds only if the claims or losses arise out of or result "from risks that the contract defines as unusually hazardous or nuclear in nature." This language is both unfortunate, as well as confusing. It is unfortunate in that it is frequently not the inherent danger (unusual hazard) of a thing or activity which poses the possibility of a major catastrophe; it is the sheer magnitude of potential damage which could be caused by an accident even though the thing or activity is considered generally safe. In view of the tremendous effort, care and money expended to minimize the possibility of accidents in programs such as space exploration, it is not surprising that agency heads are loathe to characterize the risks in such programs as "unusually hazardous." (See note 10, supra). The requirement for a finding of unusual hazard is confusing since the phrase is immediately associated with the tort doctrine of absolute or strict liability for abnormally dangerous things or activities.

This doctrine stems from the celebrated English case of Rylands v. Fletcher.[17/] In analyzing and commenting on this doctrine, Prosser uses the phrase "strict liability"[18/] but the phrase "strict liability" is also used to cover non-abnormal hazards associated with a manufacturer's liability for defective products.[19/] The confusion inherent in this dual usage of the term "strict liability" is strikingly evidenced in the opinions rendered by the Supereme Court in the Nelms v. Laird case referred to supra. Justice Rehnquist's majority opinion dealing with the question of governmental liability for damage caused by sonic booms, leads off by referring to the "theory of strict or absolute liability for ultrahazardous activities...". He next speaks in terms of "absolute or strict" liability, then refers to "absolute liability," and finally to "strict liability" for the remainder of his opinion. In contrast, Justice Stewart, in dissent, eschews the use of the phrase "strict liability" entirely, and considers the issues posed in the case (properly in our view) as coming under the doctrine of "absolute liability."

But whatever you call it, liability for unusually, ultrahazardous, or abnormally dangerous things or activities is a different legal concept from the doctrine of strict liability in the product liability sense. It is the doer or possessor of abnormally dangerous activities or things who is the tort feasor under the unusual hazard (Rylands v. Fletcher) doctrine--not a manufacturer of a defective but otherwise usually safe product as in the products liability case. Hence, if the Rylands v. Fletcher doctrine were properly applied to claims resulting from accidents in Government programs, it should be the Government and not its contractors who are ultimately liable.

There are, unfortunately, other impediments to the use of P.L. 85-804 for contractor indemnification. They were extensively analyzed and documented in the Report of Study Groups No. 8 of the Government Procurement Commission referred to above. To summarize briefly, these include difficulty in reaching agreements as to the definition of the precise risks which are to be identified as unusually hazardous, as well as a reluctance on the part of a contractor to expressly agree that its performance under a contract involves such serious risks. (See note 10, supra). In addition, the willingness of contractors to accept contracts without indemnification eliminates any inclination by the contracting agency to provide it. It is equally certain that if a prime contractor is willing to accept a contract without indemnity, the prime will, in all but the most unusual cases, not be convinced to press for it at the urging of a putative subcontractor. This conclusion is hard to avoid even though the subcontractor may perceive its risks to be substantially greater than the prime's. Thus the plight of the subcontractor, frequently a small business enterprise unable to afford enormous insurance coverage, is worse than the prime's.

POLICY CONSIDERATIONS FOR NEW LEGISLATION

As can be readily seen from the long history of the pendency of this issue, arguing that new catastrophic indemnification legislation is desirable--even necessary--is a far cry from the actual enactment of a new law. And the differing approaches of the various draft bills which have been offered compels a recognition that there is no solid consensus as to the substance such a law should contain. Until the 1978 OFPP draft bill was released for review and comment, all earlier draft bills contained some form or other of the "unusually hazardous" risks qualifier discussed above, and required under P.L. 85-804.[20] Similarly, the AIA draft bill, as well as the Task Group draft bill, as mentioned earlier, contained an overall dollar limitation on liability, whereas the 1978 OFPP draft bill did not. The reasons for this apparently arbitrary decision to impose an overall dollar liability limit, irrespective of the amount of damage actually caused by a catastrophic accident, can only be explained in terms of a perceived unwillingness on the part of the government to shoulder unlimited liability--and yet, unlimited liability is precisely what was agreed to with respect to foreign claimants under the Space Treaty covering international liability for Damage Caused by Space Objects, supra., and is the potential liability confronting a contractor unless the accident is covered by the Price-Anderson Act.

Indemnification Threshold

Another sticky point which has bedeviled many who have worked to come up with a draft bill has been the issue of government indemnification versus the business interests of the insurance industry. Naturally, insurance underwriters could be expected to oppose legislation which would seriously damage their business. Indeed one spokesman stated to the Government Procurement Commission, Study Group No. 8, that, "the adoption of a general program extending first dollar Government Indemnification for any activity that is touched by the hand of the Government, so to speak, would seriously damage--indeed, it might destroy--the private property and casualty insurance business."[21/]
This spokesman later stated that:

> "Insurers feel that Government indemnity should apply only to Government programs which would involve a catastrophe potential, and, with respect to such programs, should attach only when the amount of loss resulting from a major accident exceeds a realistic appraisal of the amount of principle insurance available at reasonable cost...". [22/]

This point was honored in the Procurement Commission's Recommendation H-5 quoted, supra. Both the Task Group and 1978 OFPP draft bills incorporate this approach. However, the earlier AIA bill finessed the issue by leaving the amount of insurance to the contractor but limiting indemnification to claims in excess of $10 million. Both the Task Group and 1978 OFPP bills provide indemnification only when liability exceeds the amount of insurance which the parties agreed was reasonably available and approved by the government at the time of contracting for government indemnification.

Similar to the Price-Anderson Act (note 6, supra), the 1978 OFPP bill pegged at $60 million the amount of insurance deemed to be reasonably available and beyond which government indemnification would apply. This bill would have permitted discretionary adjustment of this threshold in specific situations where a case could be made for a different amount. The Task Group bill, as well as P.L. 85-804, both left the issue entirely to ad hoc case-by-case determination. Regardless of whether the pegged amount or the case-by-case determination approach is used, there are thorny and practical difficulties confronted in any attempt to establish this indemnification threshold. The nub of the problem lies in the subjectiveness of virtually any determination of the amount of insurance "reasonably available" to a given indemnitee.

Recognizing this difficulty and reflecting continuing dissatisfaction with the "pegged amount subject to adjustment" approach taken in its 1978 draft bill, OFPP solicited representatives of the insurance industry to come up with guidelines which could be either incorporated into a revision of the 1978 bill or implemented by regulation if and when new indemnity legislation was enacted. While this task was given to the insurance representatives in 1978, no response was forthcoming. Due to the inherent objectiveness of such determination, it is problematical whether such a set of guidelines can be adduced. They would have to accommodate the reasonable interests and expectations of all involved parties.

Availability of Insurance

Certainly, insurance which may be "reasonably available" to a large multiline international corporation very well may not appear "reasonably available" to a much smaller firm with commensurately diminished overhead and expense budgets. And, since insurance premium costs presumably vary with the nature of the risks involved--the bigger the risk, the higher the premium--the Government could very well consider its own interests best served by providing total government indemnification against a high risk undertaking by a contractor rather than reimbursing him and presumably his subcontractors for the costs of maintaining very expensive insurance coverage for even a part of the risk. Furthermore, from an insuror's point of view, some of the risks involved in Government programs may well be so unique that effective risks spreading or distribution amongst a number of insureds may be impossible. Hence, the premium costs to the single insured must, in the long perspective, ultimately equal the total liability incurred plus a markup for expenses and profit.

Left unresolved in all these draft bills, and indeed, indemnification under Public Law 85-804, is the problem of a contractor's inability to secure or maintain the required insurance after the indemnification threshold has been contractually established. Illustrative of this difficulty is paragraph (3) of the Indemnification clauses set forth in ASPR 7-303.62 and 7-404.57 which are applicable to indemnification under P.L. 85-804. This paragraph (3) states:

> "(3) If insurance coverage or other financial protection program approved by the Secretary is reduced, the liability of the Government under this clause shall not be increased by reason of such reduction."

Presumably the intent of this paragraph is to prevent an indemnified contractor from deliberately reducing his insurance and insurance costs after he becomes indemnified, thereby lowering the indemnification threshold and generating a windfall in the amount of the unexpended premium dollars. Unfortunately, the language also covers unintentional and undesired (as far as the contractor is concerned) reductions in coverage as well.

Open-Ended Insurance

This problem is exacerbated by the indefinite but potentially quite long period of risk confronting the contractor after delivering his product or service. Indicative of this long duration of exposure to third party liability and the expansion of a contractor's exposures because of the continuing pro-victim liberalization of product liability doctrines and trend toward contraction of Government exposure under the Federal Tort Claims Act, is the case of Henry v. Bell Textron (note 15. supra). The contractor delivered its product to the Government a full ten years before the accident giving rise to its liability occurred. The product--a Bell UH1H helicopter--was delivered to the Federal Government in 1966, served two combat tours of duty in Vietnam, had been overhauled on two occasions, and had been modified by normal maintenance to the extent that virtually every relevant part had been replaced at least twice since its manufacture. The evidence also suggested that the aircraft had incurred battle damage in Vietnam on at least one occasion. The accident involving this helicopter occurred early in 1976, and resulted in the death of the two pilots on board. At the time of the accident, the helicopter was assigned to the Virginia Army National Guard, and the two deceased pilots were performing training duty as members of the Guard.

Absent government sponsorship of a risk-creating enterprise, present legal doctrine allocates such risks either to the manufacturer of the product which caused the catastrophe--if it was defective or negligently produced--or to the person who engaged in the activity which caused the catastrophe--if such activity is considered abnormally dangerous. Insurance is resorted to by private individuals to protect themselves from being wiped out by liability for such man-made disasters. If the potential risks are so large that such protection is inadequate or unavailable, it is presumed that the activity will not be pursued, and the risks will not be run. However, when the Federal Government undertakes an activity, the doctine of sovereign immunity insulates it from all tort liabilities other than those permitted under the Federal Tort Claims Act (or a Treaty). As pointed out earlier, the discretionary function and other exceptions to the waiver of immunity effected by the Act drastically reduce the likelihood that a domestic plaintiff can successfully prosecute suit against the Government. As a consequence, the government contractor becomes a much more convenient, and in many cases the sole defendent. As is indicated in Judge Haynsworth's opinion and clearly established in the briefs on appeal, Bell Textron was much less blameworthy for the accident than the government. The Aircraft Accident Report prepared by the Department of the Army and testimony developed during the pretrial discovery clearly indicated that the government "defendants were more responsible for the crash than Bell Textron." This conclusion was accepted by the 4th Circuit; the quoted remark is from Judge Haynsworth's short opinion. The relative ease with which a contractor defendant can be held liable and the much greater difficulty confronting a plaintiff proceeding under the Federal Tort Claims Act against the Government indicate a high probability that in litigation resulting from a catastrophe, it will be the contractor and not the Government which will be held liable even though the Government and not the contractor was primarily responsible for the accident. One last quote from Judge Haynsworth's opinion buttresses this conclusion:

> "Bell Textron is placed in a very difficult position by the expanding doctrines of products liability and the relatively inflexible doctrines of sovereign immunity and Eleventh amendment immunity, but unfortunately for it, the law is clearly against it."

Strict Liability

Numerous cases have been decided against government contractor defendants which reinforce the concern stated so succinctly by Judge Haynsworth in the Bell Textron case. See Boeing Airplane Co. v. Brown, 291 F 2d 210 (9th Cir, 1961), Foster v. Day and Zimmerman, 502 F, 2d867 (8th Cir, 1974); Challoner v. Day and Zimmerman 512 F.2d 77 (5th Cir, 1975) judgment vacated and remanded for further proceedings 423 &.S. 3 (1976); Barr v. Brezina Construction Co., 464 F. 2d 1141 (10th Cir, 1972); Stencel Aero Engineering Corporation v. U.S. note 14, supra. In all of these cases it is submitted that, but for the sovereign immunity and other defenses available to the Federal Government, the original plaintiffs would have had viable theories of recovery against the Government. In none of them, however, was a suit by the original plaintiff against the Government allowed to be litigated, since the Government was uniformly successful in securing a dismissal of plaintiff's suit as to it. The contractors bore the brunt. The theory successfully relied upon by plaintiff in the Boeing v. Brown case was negligence, while the successful theory in the subsequent cases was that of strict liability in tort. Boeing, of course, was adjudicated before the doctrine of strict liability in tort was given full judicial endorsement in the celebrated Greenman v. Yuba case, [23/] hence it is readily apparent that once this doctrine was enunciated, the courts were quick to validate its use against government contractors even though in such cases the policy underpinnings usually ascribed to the doctrine are slim or non-existent.

These policy considerations are often stated as follows:

1. Strict liability in tort will induce manufacturers to be more careful.

2. Strict liability in tort will induce manufacturers to make products which fulfill the expectations of consumers.

3. Manufacturers who place their products in the stream of commerce accept a special duty to the public, and

4. The manufacturer of a product is better situated to bear losses resulting from the use of this product, since he can spread such losses across all users by covering such costs in his price.

Government Contract Defense

The arguments that these policy underpinnings do not exist in many government contract situations has been advanced in many cases including the Day Zimmerman cases, Barr and Stencel cases, supra, but the courts have been slow to recognize such arguments (which have been termed the so-called "government contract defense") in strict liability cases and there are few jurisdictions where a defendant has prevailed in such cases on this basis. Lower court decisions allowing this defense have been recorded in New Jersey,[24/] New York,[25/] and Illinois[26/]. In the huge "Agent Orange"[27/] class action suit on behalf of 2.4 million Vietnam veterans and their families against nineteen chemical company contractors, the New York Federal Court in an interlocutory ruling has also recognized a form of this defense, although it remains to be decided whether the defendants can pass the tests laid down by the Court to establish it. In each of the cited cases, as well as the "Agent Orange" ruling, the requirements of the defense have been stated differently, and it remains to be seen if, over the years, the appellate courts will ultimately endorse this defense and in the process, agree on a predominant version of it. In view of the wide disparity between the fifty-one jurisdictional versions of what constitutes strict product liability itself, the development of a widely adopted, generalized rule constituting the government contract defense is most unlikely.

In a number of cases holding government contractor defendants liable for product-caused injuries, attempts were made by the contractor defendants to implead the Federal Government as a party and to secure, under one theory or another, tort contribtuion or indemnification. This was done in Stencel, Bell Textron and Brezina. Such efforts were uniformly unsuccessful, albeit an analysis of these decisions indicates that the question may not be completely resolved. In Stencel, the Supreme Court refused to allow a contractor to recover from the United States damages which the contractor was required to pay to plaintiff, since the United States had a defense against plaintiff's claims under the Federal Tort Claims Act. There were enough facts in common between Stencel and Bell Textron for the Fourth Circuit to cite and rely on Stencel in its rejection of that appeal. In both Stencel and Bell Textron the suits by the original plaintiffs were dismissed as against the United States on the basis of the doctrine enunciated by the court in Feres v. U.S.[28/] This doctrine precludes suits against the United States under the Federal Tort Claims Act for injuries sustained by a member of the armed forces while on active duty. In Stencel, the Supreme Court affirmed that since the United States could not be held liable to the plaintiff directly, to permit such indemnification or contribution would be the same as doing away with the Government's defense against the plaintiff's claim in the first place.

If, as one may wisely conclude, the government contractor faces bleak prospects in defending against product liability claims in general, it is hard to conceive that he would be any more successful in litigation resulting from a major catastrophe.

CONCLUSIONS

As our first conclusion, we must reiterate the conclusion of the Columbia Study almost twenty years ago: "We have found that under present law, there is no assurance of compensation to the victims of a catastrophic accident, at the same time contractors are exposed to the danger of devastating liabilities with no sure means of guarding against them."[29/] This conclusion was reaffirmed by the Government Procurement Commission in 1972 and unfortunately, is as valid today as it was at the time The Columbia Study was published in 1963.

The contract-by-contract approach to indemnification under existing statutory authority has resulted in inconsistancies, uncertainties, and inequities which should be eliminated by the establishment of a clear Federal policy on the subject.

The current situation is especially unfair to suppliers and subcontractors which are frequently small businesses lacking large financial resources and with relatively little bargaining power, especially when they must deal with the issue of Government indemnification on a contract-by-contract basis through a prime contractor.

The restrictions applicable to military research and development, as well as P.L. 85-804, which limits the indemnification of contractors to only such risks as are defined as "unusually hazardous," inhibits the appropriate use of these authorities. (See note 10, supra). Further, the authority to indemnify under existing statutes is limited to certain agencies and types of risks, even though other agencies lacking such authority may well undertake programs having the potential for catastrophic accidents.

Neither the military research and development statute (10 U.S.C. 2354) nor Public Law 85-804 has any provision for prompt relief of the injured public. Unlike the Price Anderson Act, neither statute provides for waiver of defenses; hence, the victims of a catastrophe are far less certain of relief under these statutes.

The emerging case law has been generally inadequate to provide fair and equitable treatment to Government Contractors who have been held liable for accidents through no fault of their own. Governmental immunity from suit shifts, unfairly, the financial burdens of such accidents to its contractors, regardless of whether the accident is catastrophic or not.

RECOMMENDATIONS

A new Federal statute providing Governmental indemnification for liability beyond reasonably available insurance in catastrophic accidents and for broader indemnification in appropriate non-catastrophe accidents, is needed and long overdue. Such a statute should overcome the inadequacies of existing statutes and common law. Such a law should contain the following features:

1. It should be a statute of general applicability not limited to only certain agency activities and types of risk. The one exception to this would be to leave undisturbed the Price Anderson Act which appears to be working satisfactorily. Indeed, the Price Anderson Act might well serve as a prototype or point of departure for the new legislation, thus enhancing the liklihood of a consistant national policy.

2. The statute should be as self-executing as is reasonably possible. In the case of a catastrophic accident, a Presidential determination that such an accident has occurred

should be sufficient to trigger indemnification. The definition of catastrophe should be based upon the probability that damages in excess of a stated amount are likely to have occurred as a result of the accident. The indemnification should flow to all program participants, be they contractors, licensees, or grantees, or their subcontractors, sublicensees, or subgrantees of any tier.

3. Regardless of whether a catastrophe as defined has occurred, indemnification should flow when it can be shown that the contractor was not at fault and had complied with the performance requirements of its contract and that the Government was primarily responsible for the accident. In non-catastrophe cases, such a statute might well establish a comparative responsibility basis for allocating the financial burdens of accident victim compensation.

4. In the catastrophic accident situation, the Federal agency should be allowed discretion on the matter of insurance and private financial protection. Provided, however, that in any event, indemnification would be provided if the Contractor can show that its liability is beyond such insurance as was reasonably and practically available to it.

5. In the catastrophic situation, the statute should contain some provision for prompt victim relief. Interim relief and waiver of defenses should be considered and could, approrpiately in our view, be incorporated into such a statute.

Footnotes

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1. Report of the Commission on Government Procurement, Vol. 4, Part H, Appendix A at p. 104 (1972).

2. Ibid at pp. 101-102.

3. Committee on Federal Legislation of the Association of the Bar of the City of New York, Protection Against Catastrophic Accidents in Connection With Governmental Activities: A Legislative Proposal, A Report, July 1968.

4. U.S. Congress, House Report 91-468, August 12, 1969.

5. Report on Recommendations H-4 and H-5 (Catastrophic Accidents) of the Commission on Government Procurement by the Task Group established to develop legislation to carry out the executive branch positions approving Recommendations H-4 and H-5 of the Government Procurement Commission on file with the OFPP. The quote is from Page 4.

6. 41 U.S.C. 2210, the Price-Anderson Act.

7. 42 U.S.C. 201, The National Swine Flu Immunization Program of 1976 (P.L. 94-380).

8. Senate Report No. 2281, 85th Congress, 2d Sess. (Aug. 9, 1958).

9. Executive Order 11610, July 22, 1971, 36 Fed. Reg. 13755.

10. But see Public Law 95-335 which made P.L. 85-804 applicable to the northeast Corridor Improvement Program "notwithstanding any other provision of law." The purpose was to permit indemnification under P.L. 85-804 "without the necessity of any determination by the Secretary (of Transportation) and without referral to our consideration of any such agreement by either House of Congress" H.R. Report 95-1329 (Conference Report). See also P.L. 96-514 and P.L. 97-100 which contain a provision authorizing DOE to use P.L. 85-804 to provide indemnification for specified synfuel projects. The special authority was granted, in part, to get around the "unusually hazardous" restriction which no one wanted to ascribe to those projects.

11. 28 U.S.C. 1346 et. seq.

12. Federal Tort Claims Act: construction of provisions excepting claims involving "discretionary function or duty," 99 ALR 2d 1016.

13. Multilateral Convention on International Liability for Damage Caused by Space Objects, Mar. 29, 1972 TIAS 7762, 24 U.S.T. 2309.

14. 431 U.S. 666 (1977).

15. 557 F. 2d 1163 (4th Cir. 1978).

16. Executive Order 10789, Nov. 14, 1958, 23 Fed. Reg. 8897 extended the authority to indemnify contractors under P.L. 85-804 to the following agencies in addition to DOD: Dept. of Treasury, Dept. of Interior, Dept. of Agriculture, Dept. of Commerce, Atomic Energy Commission, General Services Administration, National Aeronautics and Space Administration, Federal Aviation Agency, Tennessee Valley Authority, and the Government Printing Office.

17. Fletcher v. Rylands, 1865, 3 H. & C. 774, 159 Eng. Rep. 737, reversed in Fletcher v. Rylands, 1866, L.R. 1 Ex. 265, affirmed in Rylands v. Fletcher, 1868, L.R. 3 H. L. 330.

18. Prosser, Law of Torts 505 (4th ed. 1971).

19. Id. 656.

20. Albeit the AIA bill after setting up the criterion for indemnification resulting from "activity of a potentially hazardous nature" went on to allow a Presidential Proclamation of a "catastrophic incident" which would be indemnified apparently even absent unusual hazard consideration.

21. Final report of Study Group No. 8, Commission on Government Procurement (Feb. 1972) at Pages 605-606.

22. Ibid at pages 606-607.

23. Greenman v. Yuba Power Products, Inc., 59 Cal. 2d 57, 27 Cal. Reptr. 697, 377 P. 2d 897 (9th Cir. 1963).

24. Sanner vs. Ford Motor Co. 144 N.J. Super. 1, 364 A.2d. 43 (1976) (lack of seat belts in a jeep).

25. Casabianca vs. Casabianca 101 N.Y. Misc. 2d 348 (1980) (dough mixer for WW II field kitchens manufactured to Army specifications).

26. Hunt, et.al. vs. Balsius (Ill. App. Ct. 1978) 384 N.E. 2d 368, (State contract specification for a traffic sign).

27. In "Agent Orange" Product Liability Litigation, 534 F. Supp. 1046 (1982) at pp. 1053-1058.

28. Feres v. U.S. 340 U.S. 135 (1950).

29. Columbia U. Legislative Drafting Research Fund "Catastrophic Accidents in Government Programs" (1963) at p. 71.

Senator GRASSLEY. Fine. Thank you very much to everybody. The meeting is adjourned.

[Whereupon, at 12:37 p.m., the subcommittee was adjourned.]

APPENDIX

LETTERS

PECO Enterprises, Inc.
320 LeClaire St. Davenport, IA 52801 (319) 323-4774

2 November 1982

Honorable Charles E. Grassley
Chairman, Subcommittee on Agency Administration
Senate Judiciary Committee
232 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator:

As the President, and principal stockholder of a minority owned small business, I am keenly interested in the purpose and outcome of your hearing actions on the indemnification of Government contractors.

The manner in which the courts have ruled puts a Government contractor in an untenable position to defend against faulty specifications and poor quality control which were required and controlled by Government contracting officers.

Although the potential liability cost is much greater for manufacturing industries than those engaged in service contracts, the inequity is still evident. I believe that the Government should assume full liability and subsequent cost when a product is accepted under terms of the contract between the parties.

I would like to have my dissatisfaction with the present conditions recorded as part of your second oversight hearing, along with those in industry who have already done so on this issue.

I would also consider making a personal appearance to express my thought if that would help bring about a greater indemnification or contribution from the Government under provisions of law.

Sincerely,

Frank L. Granados
President, PECO Enterprises, Inc.

FLG:dp

Technical Services to Government and Industry

SPECTRA ASSOCIATES INCORPORATED

2 November 1982

Senator Charles E. Grassley
Chairman, Subcommittee on Agency Administration
232 Russell Senate Office Bldg.
Washington, DC 20510

Re: The Indemnification of Government Contractors

Dear Senator Grassley:

Thank you for the opportunity to express our company viewpoint regarding government contract liability.

Spectra Associates, Inc. is a small business conducted largely to render professional engineering services in the field of telecommunications. It does not have a large financial base and must be quite careful in both cash flow and in assuming liability risks. Because of a depth of the experience of our principal and senior personnel in working with Federal and military contracts for former employers, we have concluded there is not a promise of sufficient gain for Spectra to engage in government contracting. This decision is based upon assessment of many risks including the risk of being forced to first or second tier indemnification should some agency or department misapply the results of our work.

I believe there are many other companies, too, which for similar reasons do not bid on contracts offered by the Federal government.

The following reasons are not fully pertinent to the subject, however, I risk an expression of other reasons for nonparticipation which may be interesting to you and your committee:

1. The great emphasis placed on achieving minority participation, especially for DOT contracts. Spectra has recently decided to no-bid a transit communications system design for the City of Dallas because the minority participation requirements exceeded 10 to 1 the scope of work requirements. There is, furthermore, little chance for consultants to achieve a guaranteed percentage of minority participation and an assured level of performance.
2. The administrative paperwork, and data preparation often exceed the objective technical effort thus requiring a staff overhead which cannot be supported by commercial projects, thus one cannot compete successfully in both areas.
3. The usual slow payment schedule provides a disincentive, for the finance charges often exceed any residual profit which may be left at the conclusion of a project.
4. Often the lowest bidder is selected regardless of qualifications. This is not only professionally discouraging but leads to poor results in the performance of contracts and bad reputations for all consultants.

I hope these comments are helpful to your Agency Administration Committee deliberations.

Sincerely,

SPECTRA ASSOCIATES, INC.

David M Hodgin

David M. Hodgin, P.E.
President

DELAVAN
CORPORATION

November 5, 1982

Agency Admin

1982 NOV -8 AM 10: 12 1982 NOV 10 PM 9 37

Senator Charles E. Grassley
232 Russell Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Grassley:

Your letter of October, 1982 addressed to our company regarding the hearings you are holding as Chairman of the Subcommittee on Agency Administration, Senate Judicairy Committee is acknowledged. As you, Senator, I am also an attorney. Therefore, I answer your inquiry to us as a manufacturer and a lawyer.

We have a very substantial amount of government procurement made through our companies, some directly by the Air Force and some through the aircraft engine manufacturers who then resell to the Air Force.

At this point in time we have never been sued with respect to any military contracting we have done, directly or indirectly. However, we carry very high levels of liability insurance at tremendous cost to our company with full knowledge that there is no provision for suing the Air Force should someone claim that our fuel injection equipment for jet aircraft was responsible for personal injury or death.

We are very conscious of the fact that the Air Force permits a goodly number of activities in the form of Air Force overhaul and other practices which could compromise any question of liability for injury or death in which we might become involved. We have no control over these operations of the Air Force in most cases.

For example, when our fuel injection equipment is overhauled at an Air Force base and then reinstalled on an Air Force jet, there is no way to know that the work was properly executed and yet that particular nozzle or set of nozzles still would show the specific serial number assigned by our company and would be directly traceable to Delavan.

We do not suggest that the Air Force should be responsible for defects in material or workmanship of our products. However, since everything we make is 110% inspected, it is unlikely there would ever be defects in workmanship or material. Since the Air Force is frequently involved in the installation of our equipment on jet engines, we certainly feel there should be some statutory right to involve the Air Force and the Federal Government where suit is brought specifically involving Air Force equipment. The impunity granted in prior years should be modified as has been tort liability in many states with respect to school districts and other municipal bodies.

Thank you for asking our opinion.

Yours very truly,

Robert L. Sandblom

Robert L. Sandblom
Chairman and Chief Executive Officer

LITTON INDUSTRIES
Stratford Building Two, 200 Eagle Road, Wayne, Pennsylvania 19087 215 964-1420
Law Department

1982 NOV 19 AM 11: 39

November 15, 1982

Hon. Charles E. Grassley
232 Russell Senate Office Bldg.
Washington, D. C. 20510

Re: Federal Government Tort Indemnity

Dear Senator Grassley:

The Instruments and Life Support Division of Clifton Precision Division, Litton Systems, Inc., a federal defense contractor based in Davenport, Iowa, has referred to me your recent letter concerning hearings on government tort liability.

Thank you for addressing this important issue. The Stencel Aero Corporation matter you used as an example is just one of many instances where government contractors and subcontractors have had to spend thousands of dollars to satisfy judgments or to settle claims in cases where the contractor did nothing more than to carefully follow government specifications required by its contract or subcontract.

More importantly, the Stencel matter and others like it exemplify the unnecessary loss of life and limb which often results when contractors bound to follow defective government specifications cannot make changes which, in their expertise, they feel necessary for the safer operation of equipment. An obligation on behalf of the government to indemnify contractors for damages arising from such situations would create, we believe, a strong incentive for government procurement officers to take safety considerations into account.

Moreover, another issue not to be forgotten involves the millions of dollars in higher procurement costs paid annually by the government because its suppliers must attempt to protect themselves by factoring into contract prices funds to cover their potential liability in Stencel-type cases. There probably is no way that such excess costs could accurately be measured.

As a major defense contractor/subcontractor employing over 400 Davenport-area residents in our ILSD facility and thousands more across the country, we wholeheartedly support your efforts toward providing a fair scheme for indemnifying those who incur liabilities through no fault of their own in meeting the specifications required by government contracts. We believe a full resolution of the problem will involve legislation allowing indemnity, amendment of the Anti-Deficiency Act, and, finally, a fair national products liability statute which recognizes as a defense to products liability claims the compliance with mandated government specifications.

Sincerely,

LITTON SYSTEMS, INC.

Michael Nelson Becci
Division Counsel

1982 NOV 22 PM 3:10

November 18, 1982

Honorable Charles E. Grassley
United States Senate
Washington, DC 20510

Dear Senator Grassley:

In response to your letter on government tort liability, may I first say I appreciate very much the opportunity to express my opinion.

I am not directly involved in, i.e., I do not have any direct responsibility for, procurement. I am, however, in a staff position which involves monitoring and facilitating the overall acquisition of materiel for the US Army. I have frequent contact with procurement personnel, as well as engineering, quality assurance, maintenance, supply, and safety personnel. My job title is Industrial Engineer. I have an engineering degree. Therefore, I feel I have some basis for an informed opinion.

My opinion is that the agency or individual responsible for the design approval of an item must bear the blame if that item proves faulty or less than adequate for its intended use. Note that I said design approval. In the case cited in your letter, this is the Air Force, not the contractor. Each case has to be considered separately, of course, since there are numerous types of contract arrangements, and frequently the nominal approval authority doesn't have very much control or input to the design. In the cited case, it appears the contractor was compelled to accept the Air Force design modification, or face a penalty, possibly contract termination. The government should have borne the penalty for the flaw, if there was a flaw. This raises a second and possibly more difficult question. Who determines that a design is faulty or inadequate? It has been my belief for many years that far too many times the answer is, people who have no technical training, no understanding of the design process, such as lawyers, accountants, physicians, etc. While they are usually well meaning, their lack of knowledge and understanding is dangerous. No design is perfect, no designer can anticipate all possible situations his design may face. The design process must have boundary conditions set for the item being designed. Also, the designer can't be responsible for misuse. "An item can be designed to be fool-proof, but not idiot-proof."

Having expressed myself at length on these two points, let me summarize by saying that to put the entire responsibility on the contractor, especially by the legalistic argument that the government can't be sued, presumably under the doctrine that the Federal Government is soverign and can only be sued with its consent; is manifestly unfair and illogical. It also has the very practical drawback, as you know, that it makes contractors much less willing to do business with the Federal Government. We already have enough hurdles, such as the Defense Acquisition Regulation, to surmount to get private sector participation in Defense production. We don't need any more.

Thank you again for soliciting my opinion.

Sincerely yours,

Herbert E. Moore

HERBERT E. MOORE
4 Parkwood Drive
Davenport, IA 52803

AMERICAN INSURANCE ASSOCIATION
1025 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 293-3010

November 30, 1982

The Honorable Charles E. Grassley
Chairman
Subcommittee on Agency Administration
4-B Russell Senate Office Building
Washington, D.C. 20510

Re: Federal Government Indemnification of Contractors

Dear Senator Grassley:

The American Insurance Association (AIA) is a trade association of 169 property and casualty insurance companies. The member companies of the AIA are major providers of general liability insurance, products liability insurance and workers' compensation insurance. These lines of insurance make up the bulk of the type of coverage necessary to respond to government contractor liability.

The member companies of the Association believe that government indemnity should apply only to government programs which involve a catastrophic potential and, with respect to such programs, should attach only when the amount of the loss resulting from a major incident exceeds a realistic appraisal of the amount of private insurance available at reasonable cost. If underlying financial protection is required at less than the amount of private insurance available, the government would assume a greater portion of the role of indemnification than necessary, and the development of private insurance capacity sufficient to reduce the extent of government involvement would be diminished.

The AIA does not oppose either administrative action or legislation extending indemnity to private persons or organizations in instances in which private insurers are unable or unwilling to perform their role. However, in most instances, private insurers are capable of offering property and liability insurance to government contractors. The inability of private insurers to respond to the need of government contractors is limited to the area beyond the point where the possible, although remote, consequences of a catastrophic accident exceed the amount of the financial capacity they can safely commit.

Any legislation which permits indemnification of government contractors should contain an acceptable definition of "catastrophe." A definition of this concept should be expressly adopted in legislation, rather than be subjected to varying interpretations by different administrative agencies or contracting officers. One possible approach would be to establish a specific dollar threshold above which government indemnification is triggered.

Most of the indemnity provisions used today are based upon one of the following three statutes:

- Public Law 85-804, 50 U.S.C. 1431, the successor to title II of the First War Powers Act, 55 Stat. 838.
- 10 U.S.C. 2354, which covers research and development contracts of the Department of Defense.
- Price-Anderson amendment to the Atomic Energy Act, 42 U.S.C. 2210.

Stated briefly, these statutes respectively authorize the inclusion of indemnification provisions in (1) contracts of designated agencies when determined by the head of the agency to be necessary to facilitate the national defense, (2) research and development contracts of the Department of

Defense, and (3) contracts and certain licenses of the Nuclear Regulatory Commission. The statute which applies to research and development contracts of the Department of Defense does not authorize the inclusion of indemnification provisions in procurement or production contracts.

While these existing laws provide some protection for government contractors, each is narrow in scope and permissive, rather than mandatory, in nature. Public Law 85-804 authorizes any department or agency of the government "which exercises functions in connection with the national defense" to indemnify their contractors against extra-hazardous risks. However, Executive Order 10789, implementing Public Law 85-804, provides that indemnification must be "within the limits of the amounts appropriated and the contract authorization provided therefore...." 10 U.S.C. 2354 provides for indemnification relative to DOD research and development contracts which are defined as unusually hazardous. Again, the secretary of the military department concerned may include indemnification provisions, rather than shall include indemnification provisions, in its contracts. The Price-Anderson Act is also limited in scope in that it is applicable only to nuclear facilities. Both Public Law 85-804 and 10 U.S.C. 2354 are subject to the anti-deficiency laws which preclude obligating public monies beyond available appropriations. Indemnification for catastrophic loss is of limited effect if it cannot go beyond the limits of available appropriations.

Many activities of the Government which could result in substantial danger to the public are not associated with military activities and, therefore, are not subject to the potential protection provided by existing federal law. Construction and maintenance of large dams and production, handling, storage and use of toxic materials are two examples. To the extent possible, all elements of the government contracting community should be treated equally. Consequently, the concept of government indemnification should be expanded to include nonmilitary contractors.

AIA would support indemnification legislation which would establish a fixed level above which the federal government would indemnify contractors in clearly delineated situations for which there is a recognized possibility of catastrophic loss to contractors, and private sector insurers are incapable of providing insurance coverage. This represents an expansion from existing law in that indemnification would be available to contractors who provide nonmilitary services, expertise or products. The American Insurance Association welcomes the opportunity to work with other interested parties in developing a legislative solution to the need for indemnification of government contractors involving potential catastrophic loss.

Respectfully submitted,

James L. Kimble
Senior Counsel